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Like Bamboo Shoots after a Rain: Exploiting the Chinese Law and New Regulations on Sino-foreign Joint Ventures

Zhang Yuqing

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Like Bamboo Shoots After a Rain:
Exploiting the Chinese Law and New
Regulations on Sino-foreign Joint
Ventures

Zhang Yuqing*

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* Official, Department of Treaties and Law, Ministry of Foreign Economic Relations and Trade ("MOFERT"), Beijing, China. Graduate 1974, University of International Business and Economics (China), LL.M. 1982, University of International Business and Economics (China), LL.M. 1986, Georgetown University Law Center.

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The views and opinions in this Article are those of the Author and do not necessarily reflect those of the Chinese government.

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I. INTRODUCTION

Joint ventures between Chinese and foreign investors, like bamboo shoots after the rain, have sprung up rapidly throughout the People's Republic of China (the "PRC" or "China") during the past eight years. By the end of 1986, there were 7,738 enterprises involving foreign investment in the PRC, including 3,210 equity joint ventures, 4,390 contractual joint ventures, and 138 wholly foreign-owned ventures.¹ In connection with these ventures, China garnered contracts for \$16.7 billion in overseas investment from over 30 countries and regions worldwide, \$7.43 billion of which has already been invested.² Fifty percent of the 7,738 enterprises went into production and 90% of the enterprises in operation are running smoothly and earning profits.

The United States is China's third largest trading partner. By the end of 1985, United States companies had directly invested \$2.1 billion in China, and the Chinese authorities had approved 130 joint ventures involving American companies. These Sino-American joint ventures represent some of the largest joint venture projects operating in China.³

The major objective of China's "open door" policy is to absorb foreign investment through successful economic dealings with foreign companies. The joint venture is a major vehicle for this objective. It is hoped that increased investment will serve to offset China's lack of domestic capital investment, raise the level of China's high technology and managerial skills, and increase China's foreign exchange earnings through the export of products manufactured by Sino-foreign joint ventures. Foreign businesses in China are interested in obtaining a share of the huge Chinese domestic market, capturing a rapid return on their investments, and being guaranteed proper repatriation channels. Although meeting each of these objectives is no easy task, the number of joint ventures in China continues to increase.

To embark upon a successful joint venture in China, foreign investors must make a thorough economic analysis of the proposed project, select a competent Chinese partner, develop an understanding of the markets for joint venture-made products, and deal effectively with both the Chinese partner and the Chinese government. Most importantly, however, investors must know the legal procedures and requirements involved in arranging a joint venture in China, and be aware of the advan-

¹ People's Daily, June 8, 1986 (overseas Chinese ed.).

² People's Daily, Feb. 9, 1987 (overseas Chinese ed.).

³ The Pingshuo Coal Mine Project, the Beijing Jeep Co., and the Beijing Boiler Project are examples of three such projects. People's Daily, *supra* note 1. See also *U.S.-China Coal Venture Proceeds*, J. COM., Dec. 4, 1986.

tages that Chinese law and regulations offer. The purpose of this Article is to describe the general legal framework for establishing an equity joint venture in China, and to analyze the effect of these laws and regulations on Sino-foreign equity joint ventures. In order to make this Article of most practical use, a discussion of the recently promulgated Chinese laws and regulations is included.

II. GENERAL CHARACTERISTICS OF CHINESE JOINT VENTURE LAWS

A. Definition, Ownership, and Liabilities

A Sino-foreign equity joint venture is an enterprise which is jointly invested in and managed for a particular commercial purpose by a foreign individual, company, or other economic organization, and a Chinese company or economic organization.⁴ A joint venture can be comprised of as few as two parties—one Chinese and one foreign. It can also consist of more than one entity from either side. The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment ("Joint Venture Law" or the "JVL") places no upper limit on the amount the foreign party can invest in a joint venture project, but a minimum of 25% foreign investment is required.⁵ A Sino-foreign joint venture set up in China is a separate entity from its parent companies and undertakes limited liability.⁶ Parties to a joint venture must share the risks, profits, and losses of the venture in proportion to their respective investments of capital.⁷

B. Foreign Investment Protection

Prior to the initiation of the "open door" policy in December 1978, China had neither laws nor regulations governing foreign investments.

⁴ Almost every Chinese economic entity, whether collectively owned or wholly owned by the people, has the right to enter a joint venture with foreign companies or individuals. Law on Joint Ventures Using Chinese and Foreign Investment, art. 1, promulgated July 8, 1979 [hereinafter Joint Venture Law or JVL], *reprinted in* CHINESE INVESTMENT GUIDE 1986 449 (1985) (China Int'l Econ. Consultants, Inc.) [hereinafter INVESTMENT GUIDE]. It is implied, however, that Chinese individuals cannot invest in joint ventures. In fact there are very few ventures in the People's Republic of China ("China" or the "PRC"), if any, involving an individual Chinese proprietor.

⁵ JVL art. 4. If the foreign investment in a joint venture constitutes 100% of the investment, however, it is governed by the Law on Wholly Foreign-Owned Enterprises, promulgated Apr. 12, 1986, *reprinted in* LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 1986 (Practising Law Institute Commercial Law and Practice Course Handbook No. 405, 1986).

⁶ Implementing Regulations for the Law on Joint Ventures Using Chinese and Foreign Investment, art. 19, promulgated Sept. 20, 1983 [hereinafter Joint Venture Regulations or JVR], *reprinted in* INVESTMENT GUIDE, *supra* note 4, at 451.

⁷ JVL art. 4.

In implementing this "open door" policy, this void was filled by a number of new laws and regulations.⁸ These measures permitted Sino-foreign joint ventures to be created and assured protection of the legal rights and interests of foreign investors by the Chinese government.

Following the adoption of the JVL and related regulations in 1982, a new Constitution of the People's Republic of China was drafted and ratified. Article 18 of the constitution lays down the basic legal groundwork for China's foreign investment laws and regulations. Under this article foreign enterprises, economic organizations, and individuals are permitted to invest in China and to enter into various forms of economic cooperation with Chinese enterprises and economic organizations in accordance with the law of China. Article 2 of the Joint Venture Law, in turn, directly guarantees foreign investors all investments and profits under "agreements, contracts, and articles of association authorised by the Chinese Government," as well as the investor's "other lawful rights and interests."

The Chinese laws and regulations regarding foreign investment provide the Chinese and foreign partners with detailed procedures for establishing a joint venture and set out the rights and interests that the foreign partner is entitled to enjoy. In effect, within only a few years China has

⁸ Since 1979, China has promulgated the following laws and regulations regarding foreign investment:

- 1) The Joint Venture Law;
- 2) The Joint Venture Regulations;
- 3) Regulations on the Registration and Administration of Joint Ventures Using Chinese and Foreign Investment, promulgated on July 26, 1980 [hereinafter JVR on Registration and Administration], *reprinted in INVESTMENT GUIDE, supra* note 4, at 460;
- 4) Procedures for the Registration, Examination and Approval of Joint Ventures Using Chinese and Foreign Investment, promulgated on Apr. 24, 1981 [hereinafter JV Registration Procs.], *reprinted in INVESTMENT GUIDE, supra* note 4, at 468;
- 5) Provisions of the People's Republic of China for Labor Management in Joint Ventures using Chinese and Foreign Investment, promulgated on July 26, 1980, *reprinted in INVESTMENT GUIDE, supra* note 4, at 470;
- 6) Procedures for the Implementation of the Provisions for Labor Management in Joint Ventures Using Chinese and Foreign Investment, promulgated on Dec. 14, 1983, *reprinted in INVESTMENT GUIDE, supra* note 4, at 471;
- 7) Provisional Regulations on the Standards of Registration Fees To Be Paid by Joint Ventures Using Chinese and Foreign Investment, promulgated on Feb. 2, 1982, *reprinted in INVESTMENT GUIDE, supra* note 4, at 474;
- 8) Regulations on the Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises, promulgated on Jan. 30, 1982, *reprinted in INVESTMENT GUIDE, supra* note 4, at 475;
- 9) Provisional Regulations for Providing Loans to Joint Ventures Using Chinese and Foreign Investment by the Bank of China, promulgated on Mar. 13, 1981, *reprinted in INVESTMENT GUIDE, supra* note 4, at 479;
- 10) Accounting Regulations for Joint Ventures Using Chinese and Foreign Investment, promulgated on Mar. 4, 1985, *reprinted in INVESTMENT GUIDE, supra* note 4, at 481.

created a sophisticated body of investment laws which are now playing a crucial role in attracting foreign investment to China.

In addition to the domestic legislation for absorption and protection of foreign investment, China has also signed a number of investment-protection agreements with foreign governments to ensure foreigners' investments and legal rights.⁹ The rights and commitments of both sides in an investment-protection agreement are reciprocal, despite the fact that China's investments abroad are presently very small. These agreements guarantee a foreign investor in China the same rights enjoyed by foreign investors in the other country to the agreement. In addition, the agreements assure compensation of foreign investors if China expropriates their investments in the public interest and repatriation of investments, profits, loan payments, or licensing fees by the foreign investor.¹⁰

China has also signed taxation treaties with fourteen countries¹¹ and is negotiating similar agreements with a number of others.¹² These agreements deal with avoiding double taxation and guarding against tax evasion.

Foreign investors in the past few years, especially in 1986, complained to the Chinese government about the difficulties involved in undertaking joint ventures in China. Complaints focused largely on the red-tape, high costs, and labor problems encountered in doing business with China. The Chinese government promised to improve the investment climate and reiterated that the "open door" policy would continue.

The new regulations examined in this article are a response to foreign investors' complaints. These regulations will be compared with their stated purpose, which is to help existing joint ventures overcome their difficulties. Only if investors are convinced that the laws and regu-

⁹ Up until now, China has signed foreign investment promotion and protection agreements with eighteen countries, including Romania, Sweden, the Federal Republic of Germany, the Belgium-Luxembourg Economic Union, Finland, Norway, Italy, Thailand, France, and Denmark, among others. China is currently negotiating similar agreements with the United States and other countries. The Ministry of Foreign Economic Relations and Trade of the PRC ("MOFERT") is responsible for negotiating such agreements with foreign countries to ensure foreigners' investments and legal rights. See *People's Daily*, Feb. 15, 1987, at 6, col. 1 (overseas Chinese ed.).

¹⁰ For examples of such protection agreements, see *infra* note 148.

¹¹ MOFERT represents the Chinese Government in negotiations of such agreements. China, thus far, has concluded avoidance of double taxation agreements with Japan, the United States, the United Kingdom, France, the Federal Republic of Germany, Belgium, Singapore, Malaysia, Canada, Finland, Denmark, Norway, Sweden, and New Zealand. See *People's Daily*, *supra* note 9. See also *People's Daily*, Oct. 23, 1986 (overseas Chinese ed.). See generally Easson & Li, *Taxation of Foreign Business and Investment in the People's Republic of China*, 7 NW. J. INT'L L. & BUS. 666, 693-94 (1986).

¹² Switzerland, Holland, Austria, Australia, Czechoslovakia, Yugoslavia, and Romania are countries presently discussing such agreements with China. *People's Daily*, *supra* note 9.

lations governing joint ventures effectively promote their interests can China hope to live up to its stated policy of opening the doors to the world.

C. Principal Requirements for Foreign Investment

The major goals of the "open door" policy are to acquire hard currency abroad and to import high technology and Western methods of management to boost the lagging Chinese export sector and economy.¹³ Although in the past few years a majority of joint venture projects established in China have been small and concentrated in the service industry, the general development of joint venture business in China has been rapid and successful. The Chinese government is determined to continue improving the investment climate by directing foreign investment towards production-oriented industries, especially the country's infrastructure, energy and communication industries.

According to past practice, if the products to be manufactured by a proposed joint venture are not superior to similar Chinese products, the foreign investors are usually required to buy back a large portion in order to balance the foreign exchange expenditures. If the products are highly sophisticated and manufactured with advanced, desirable technology provided by foreign partners, or if the products are urgently needed in China, they can be sold domestically and counted as equivalent foreign exchange expenditures, or may be used as import substitutes. In such cases, the foreign partners may not be required to buy back the venture-

¹³ This goal is clearly spelled out in Articles 3 and 4 of the Joint Venture Regulations. Art. 3 provides:

Joint Ventures established in China shall be able to promote the development of China's economy and the raising of scientific and technical levels, benefitting socialist modernisation and construction. The main industries in which it is permitted to establish joint ventures are:

1. Energy development, building materials, chemicals and metallurgy;
2. Machine manufacturing, instruments and meters and off shore petroleum exploitation equipment manufacturing;
3. Electronics, computers, and communications equipment manufacturing;
4. Light industry, textiles, foodstuff, medicine and medical apparatus, and packing;
5. Agriculture, animal husbandry and aquaculture; and
6. Tourism and services.

Article 4 provides:

Joint Ventures for which establishment is applied shall put stress on economic results and shall meet one or several of the following requirements:

1. They shall adopt advanced technical equipment and scientific management methods, enabling them to increase the variety of products, raise the quality and quantity of products, and conserve energy and materials.
2. They shall be of benefit to the technical reform of enterprises, enabling them to achieve quickly apparent results and large returns on small investment;
3. They shall be able to expand the export of products, increasing foreign exchange income; and
4. They shall be able to train technical and managerial personnel.

made products. Such arrangements however, must be approved by the Chinese government beforehand.

III. STEPS INVOLVED IN ESTABLISHING A SINO-FOREIGN JOINT VENTURE

A. Finding the Right Partner

It is critical that foreign companies use the appropriate channels to approach potential Chinese partners. Foreigners who attempt to use private connections to establish joint venture projects usually fail. Many Chinese corporations and government agencies can help foreign investors find Chinese partners. The major channels are national and provincial organizations.

1. *National Channels*

National channels are those Chinese organizations or corporations whose business activities cover the entire nation. Through these channels, foreign investors may obtain comprehensive policy and legal advice, as well as aid in finding prospective Chinese cooperators.

a. Bureau of Foreign Investment Control, Ministry of Foreign Economic Relations and Trade

Although this Bureau's main function is to examine and approve large joint venture projects, its personnel are familiar with projects seeking cooperation with foreign investors nationwide. Given that the Ministry of Foreign Economic Relations and Trade ("MOFERT") has close connections with these various projects, the staff can give foreigners valuable advice as to which provincial authorities and economic entities foreigners should contact.

b. The China International Trust and Investment Corporation and other consulting corporations

The China International Trust and Investment Corporation¹⁴ (the "CITIC")—and other consulting corporations, such as China International Economic Consultants, China Foreign Economic and Trade Consultants Corporations, the Bank of China Trust and Consultancy Company—can provide economic and legal consulting services pertaining to foreign investment and other economic activities. Such services include advice on projects, information on possible partners, feasibility studies, credibility investigations, and general market research.

¹⁴ See INVESTMENT GUIDE, *supra* note 4, at 261-282.

c. Specialized corporations

There are many corporations in China which specialize in trade, economic cooperation, and joint ventures in certain industries.¹⁵ Most of these corporations' headquarters are located in Beijing, either affiliated with an industrial ministry or under the direct leadership of the State Council. These corporations may arrange projects between foreign investors and Chinese enterprises in the various provinces themselves, or through their provincial branches. Foreign investors can contact these specialty corporations directly. A car manufacturer, for example, who wishes to set up a joint venture in China, may contact the China Automotive Industry Corporation in Beijing.

d. Law offices

In the past few years, a number of law offices have emerged in China. Some of these offices, such as the Global Law Office under the China Council for the Promotion of International Trade, and the Great Wall Law Office under MOFERT, handle joint venture business.

2. *Provincial Channels*

The provincial channels directly parallel the national channels—that is, there exist provincial government agencies, provincial CITIC and consulting corporations, provincial industrial corporations and law offices which the foreign investor may consult when seeking a joint venture partner. The major channels in each province are the economic and trade commissions and the provincial or municipal economic cooperation and development corporations. Because China's economy is undergoing decentralization, these provincial channels are increasingly important in the joint venture field.¹⁶ To insure efficiency and sincerity in economic cooperation, foreign companies are advised to present their preliminary proposals to the Chinese corporations or government authorities. More detailed descriptions of the products, associated technology, and sales arrangements attached to these investment proposals will definitely accelerate the process of mutual understanding and cooperation.

¹⁵ *Id.* at 287-332.

¹⁶ In addition to the formal channels, the Chinese government and Chinese enterprises and academic institutes hold regular trade exhibitions, investment discussions, and seminars on economic cooperation in order to help Chinese enterprises and foreign investors come together. The Guangzhou (Canton) Fair, held twice a year, has also been used as a regular occasion for meetings between foreign investors and their Chinese partners.

B. Negotiation: Letter of Intent, Feasibility Study, and Contract

After the appropriate Chinese partner is found and both parties are satisfied with each other's capabilities (production capacities, financial situations, technology, locations, capital, and personalities), the parties can negotiate by correspondence, or in person, concerning the future joint venture's activities and production. These negotiations should include the project's location, scale of production, total investment, shares of investment by each party, form of investment, division of profit, source of funds, and method of marketing.

At the beginning of such negotiations, the two parties usually conclude a "memorandum of understanding" or "letter of intent." This preliminary document is not legally binding, but demonstrates the intentions of the parties to cooperate and outlines the objectives of the future joint venture. After execution of the preliminary memorandum, the Chinese side presents both a project proposal and preliminary feasibility study to the supervising and ratifying departments.¹⁷ The project proposal includes the creditworthiness of the foreign party, the objective of the joint venture, the sphere of operation, the scale of production, the amount of investment (total and by partners' shares), the technological level of equipment and production, the source of raw materials, fuel, power and equipment, a market study, the expected economic results, and the term of the project.

After the project proposal and preliminary feasibility study have been examined and agreed to by the local supervising department and the authority in charge of approving joint ventures, the two parties should prepare (or retain a consulting corporation or law office to prepare) the feasibility study.¹⁸ This feasibility study is tentative because neither party has signed any formal documents yet. The major points of the study, however, will be based on the parties' mutual understanding.

The feasibility study should provide information on the parties—their names and businesses—and detailed information about the joint venture itself: its objectives, the scope of business and production, planned organizational structure, its financing and potential markets. Although the foreign side is not legally required to obtain specific approval at this stage of the joint venture, the Chinese side will need to submit the feasibility study to its senior authority in charge of joint venture projects for examination and approval. Though approval of the feasibility study by the authorities is not required under the Joint Venture

¹⁷ The project proposals and feasibility study are required under Chinese law. JVL art. 9.

¹⁸ *Id.*

Regulations, this procedure is strongly suggested,¹⁹ especially if the project will require large amounts of raw materials critical to the national economy (such as coal, petroleum, lumber, or steel).²⁰

If the feasibility study is approved, the parties will continue their negotiations and may revise the original feasibility study into a final one, taking into consideration the views of the ratifying authority. At the same time, the parties should begin to draft the agreement or contract establishing the joint venture, articles of association, and other legal documentation. Joint venture negotiations are complex and require much time. Both parties should be cautious and patient. Experienced legal advisors or lawyers are needed on both sides since joint ventures involve broad legal issues. During the course of negotiation, it is important that cooperation and friendship be shown by both parties. When the objective is determined, both parties should try their best to cooperate with each other and develop their confidence to realize their goals. Moreover, the foreign party should consult with officials of the Chinese local foreign economic and trade commissions or the central government agencies (MOFERT or the State Administration of Exchange Control) so that comments and legal advice on the project can be obtained. The foreign party should also make sure that it is not discussing a project which has no chance of government approval or support.

Finally, parties must realize that the joint venture contract and the articles of association are the most important legal documents protecting their interests.²¹ Thus, it is necessary for the parties to calculate their rights and interests based on reliable long term economic analysis during negotiation of the joint venture's basic documents.

C. Procedures for Approval and Registration

1. *Approval*

After all the legal documents have been drawn up and signed, the parties may formally apply for official approval for the establishment of a joint venture in China. The following documents should be presented by the Chinese participant to the Chinese ratifying authority: 1) an application in Chinese for the establishment of a joint venture; 2) the feasibility study, jointly prepared by the parties concerned; 3) the joint venture agreement or contract and articles of association duly signed by the parties concerned; 4) a list of the board of directors and managers of the

¹⁹ See INVESTMENT GUIDE, *supra* note 4, at 355.

²⁰ If such raw materials are to be used, the project will encounter fewer problems if the joint venture submits its plans to ongoing examination by the authorities.

²¹ See *infra* notes 33-44 and accompanying text.

joint venture appointed by the parties; and 5) signed opinions of the department in charge of the Chinese participant and the opinions of the relevant provincial, autonomous, or municipal government responsible for the joint venture business.²² The Chinese ratifying authority must render a decision on a joint venture within three months of the date on which the required documents have been received.²³

2. *Registration*

a. Documents required

If the joint venture project is approved, the joint venture must within one month from the date on which the "document of approval" has been received by the parties register with the Administration for Industry and Commerce (the "AIC") in the province, autonomous region, or municipality where the joint venture is located. When registering the joint venture, the parties must submit: 1) a request for registration²⁴ in triplicate, signed by at least one representative from each side; 2) the document of approval issued by the ratifying authority, in triplicate; 3) the basic agreements of the joint venture, including the joint venture contract and articles of association (in Chinese and the languages of the foreign parties, in triplicate); 4) the feasibility study; 5) a certificate of legitimacy issued by the appropriate government department in the foreign partner's or partners' country; and 6) "[v]erified documents concerning construction conditions, such as environmental protection, urban construction, water and power supply" issued by the Chinese authorities concerned.²⁵

²² JVR art. 9.

²³ JVR art. 10. This article does not state what happens if no decision issues from the ratifying authority within three months. One might argue, however, that contract principles from other Chinese regulations dealing with foreign economic relations apply. For instance, the regulations governing technology import contracts state that a technology import contract "shall be regarded as approved and shall come into effect automatically" if the approving authority does not make a decision within the specified period of time. Regulations on the Administration of Technology Acquisition Contracts, art. 4, promulgated May 24, 1985 [hereinafter Tech. Regs.], reprinted in INVESTMENT GUIDE, *supra* note 4, at 678-79.

²⁴ The registration form is printed and distributed by the State Administration for Industry and Commerce. This form must be filled out by the applicant and signed by the Chairman and Vice-Chairman of the board of directors of the joint venture, or the general manager and deputy general manager. Each side must have a representative sign this form. The form includes the name of the venture, its address, scope of production and business, forms of production and business, registered capital of the parties concerned, the board of directors, general manager and deputy general managers or director and deputy directors of the plant, the number and date of the approval of the document, the size of the entire staff, and the number of foreign workers and staff members. JVR on Registration and Administration, art. 4; JV Registration Procs., art. 4.

²⁵ JV Registration Procs., art.3.

b. Registered capital requirements

On March 1, 1987, the Provisional Regulations of the State Administration for Industry and Commerce governing the Ratio of Registered Capital to Total Investment by Sino-foreign Joint Ventures were promulgated.²⁶ These regulations require that the registered capital be proportional to the scale and range of production and operation.²⁷ Some specific rules are also set forth: 1) if the total investment is up to \$3 million, the registered capital must account for at least 70% of the total; 2) if the investment is from \$3 million up to \$10 million, the registered capital must account for at least 50% of the total, and in any case cannot be less than \$2.1 million; 3) if the investment is over \$10 million and up to \$30 million, the registered capital must account for at least 40% of the total and at least \$5 million; 4) if the investment is over \$30 million, the registered capital must make up to one-third of the total investment, but not less than 12 million.²⁸ Article 5 of these regulations provides that should a joint venture put up additional investment, its registered capital must increase in accordance with the regulations.

If a joint venture cannot comply with the capital registration requirements because of special circumstances, the case is reviewed by MOFERT and the State AIC.²⁹ These regulations also apply to the ratio of registered capital to total investment by Sino-foreign cooperative ventures and enterprises wholly-owned by foreigners.³⁰

After the documents required for registration³¹ have been found in conformance with the regulations, a license for operation will be issued to the joint venture.³² The joint venture is considered officially estab-

²⁶ Provisional Regulations of the State Administration for Industry and Commerce Governing the Ratio of Registered Capital to Total Investment by Sino-foreign Joint Ventures, *reprinted in* Brit. Broadcasting Corp. Weekly Econ. Rep., Mar. 4, 1987, at FE/WI430/C/1 (LEXIS, Nexis library, BBCSWB file) [hereinafter JV Provisional Capital Regs.].

²⁷ JV Provisional Capital Regs., art. 2.

²⁸ JV Provisional Capital Regs., art. 3.

²⁹ JV Provisional Capital Regs., art. 4.

³⁰ JV Provisional Capital Regs., art. 6.

³¹ See *supra* text accompanying notes 24-25.

³² The procedures for examining the registration of a joint venture are set out at JV Registration Procs., art. 5:

1) the local AIC examines the certificates and forms and notifies the joint venture if anything is found not in accordance with the regulations. The joint venture then has an opportunity to conform the documents;

2) the local authority then writes an examination report and forwards the report with the registration documents to the central government AIC for approval; and

3) the State AIC then replies to the local administration, instructing it to issue on the State AIC's behalf a "Notice of Approved Registration" and the "Business Licence."

JV Registration Procs., art. 5.

lished from the date on which the operation license is issued.

3. *Bank Accounts and Tax Registration*

After the joint venture is registered with the AIC, the next step is to open foreign exchange and Chinese currency accounts with the Bank of China (or a bank approved by the Bank of China) by presenting the joint venture's operating license. The joint venture then must register with the local tax bureau for taxation purposes.

IV. MAJOR LEGAL ISSUES FOR AN EQUITY JOINT VENTURE

A. Contractual Documentation

The Joint Venture Regulations require that three contractual documents be concluded by the parties before a joint venture can be established: the joint venture agreement, the joint venture contract, and the articles of association.³³

1. *The Joint Venture Agreement*

The joint venture agreement—reached by the parties at an early stage in negotiations—expresses “identical opinions on certain main points and principles regarding the establishment of a joint venture.”³⁴ According to the Joint Venture Regulations, this agreement is optional. If, however, the parties have concluded an agreement for the joint venture, that joint venture agreement will be binding. If the joint venture contract and the joint venture agreement conflict, the joint venture contract prevails.³⁵

2. *The Joint Venture Contract*

The joint venture contract is one of the most important legal documents concluded between the parties. It is necessary that the contract be detailed and precise in setting out the parties' rights and obligations. China presently has no corporate law to which the parties may turn in order to protect their rights and interests in areas outside the letter of the joint venture contract.

Articles 12 through 15 of the Chinese Foreign Economic Contract Law (the “FECL”) set out basic clauses required for foreign economic

³³ JVR, *supra* note 6, art. 9. Very often, however, the parties will first sign a nonbinding letter of intent or a memorandum of understanding outlining the proposed joint venture. See *supra* text accompanying note 17.

³⁴ JVR art. 13.

³⁵ *Id.*

contracts.³⁶ Those articles will also apply to joint venture contracts. Article 14 of the JVR specifies the major parts of the joint venture contract.³⁷ In addition to the law, the Department of Treaties of Law in MOFERT has formulated a model joint venture contract to aid the drafting of such agreements.³⁸ Neither Article 14 nor the model contract are exhaustive however, and the contractual needs of the parties may vary according to the particular project, arrangement or technology involved. The model contract, therefore, should only be used as a general guide to the parties, and must be modified according to the requirements of the specific situation. Nevertheless, the model contract has been widely distributed to Chinese enterprises.

Since the Sino-foreign joint venture is located on Chinese territory and is considered a legal person in China, the Joint Venture Regulations provide that: "[t]he conclusion, validity, interpretation, and implementation of joint venture contracts and the resolution of disputes thereunder shall all be governed by Chinese law."³⁹ Given the legal complexity of

³⁶ Economic Contract Law Concerning Overseas Interests, promulgated Mar. 21, 1985 [hereinafter Foreign Economic Contract Law or FECL], reprinted in INVESTMENT GUIDE, *supra* note 4, at 674. Most of the contractual clauses specified in Article 12 of the FECL parallel Article 14 of the Joint Venture Regulations. See *infra* note 37. Articles 13 and 14 of the FECL, respectively, require the parties to stipulate who bears the risks and the "effective duration" of the contract. Article 15 allows the parties to write guarantee clauses into the contract.

³⁷ Article 14 provides:

Joint venture contracts shall contain the following main contents:

1. The names, countries of registration, and legal addresses of joint venture parties, and the names, positions and nationalities of their legal representatives;
2. The name of the joint venture, its legal address, purpose, scope and scale of business;
3. The total amount of investment and the registered capital of the joint venture, the amounts of capital contribution by the joint venture parties, the ratio of capital contributions, the forms of capital contribution, the time limit for paying-in capital contributions, the stipulations on shortfalls in paying-in and assignment of amounts of capital contribution;
4. The ratio of the distribution of profits to and bearing of losses by the joint venture parties;
5. The composition of the board of directors of the joint venture, the distribution of the number of directors, and the responsibilities, limits of authority and method of employment of the general manager, deputy general managers and other high-level management personnel;
6. The main production equipment and production technology to be adopted and their sources;
7. The means of purchasing raw materials and of sale of products, and the ratio of products to be sold inside and outside China;
8. Arrangements for receipts and disbursements of foreign exchange funds;
9. Principles for the handling of finance, accounting and auditing;
10. Stipulations regarding such matters as labour management, wages, welfare, and labour insurance;
11. The term of the joint venture, its dissolution, and the liquidation procedures;
12. Responsibilities for violation of the contract;
13. Means and procedures for the resolution of disputes between the joint venture parties; and
14. The language adopted for the contract text and the conditions for effectiveness of the contract.

Appendices to joint venture contracts are to have equal validity with the joint venture contract.

³⁸ Supp. No. 4, reprinted in China Econ. News, Apr. 1, 1985, at 1-7.

³⁹ JVR art. 15. The same requirement is also found in Article 5 of the FECL.

the joint venture, the incompleteness of the Chinese legal system, and the ambiguities of some existing articles, joint venture parties will want to draft their contracts very carefully so as to avoid disputes and protect their interests by contractual stipulations should a dispute arise. According to the Chinese FECL, when a dispute arises between the parties for which no contingencies in the joint venture contract or Chinese law exist, the dispute may be resolved by referring to international norms under Article 5.⁴⁰

3. *Articles of Association*

The articles of association are concluded between the parties according to principles set out in their joint venture contracts. These articles constitute another key legal document and fulfill a role similar to the by-laws of a United States corporation. The articles of association express "the purpose, organisational principles and operational and managerial methods of the joint venture."⁴¹ The major parts of the articles of association of a joint venture are outlined in the JVR.⁴² A model set of articles of association is recommended for use by Chinese enterprises by the Department of Treaties and Law of MOFERT.⁴³ Although the joint venture contract prevails in the event of a discrepancy between it and the articles of association, the articles of association are binding.

All the basic joint venture documents—the agreement, the contract, and the articles of association—will take effect only upon approval by the Chinese government. The documents must be written in both Chinese

⁴⁰ Article 5 of the FECL states that "[c]ommon international practices may apply to cases where the laws are silent." However, controversy over the concept of "common international practices" may still remain, especially in the field of international investment.

⁴¹ JVR art. 13.

⁴² Article 16 of the Joint Venture Regulations provides:

Articles of association of joint ventures shall include the following main contents:

1. The name of the joint venture and its legal address;
2. The purpose, business scope and term of the joint venture;
3. The names, countries of registration and legal addresses of the joint venture parties, and the names, positions and nationalities of their legal representatives;
4. The total amount of investment and the registered capital of the joint venture, the amounts of capital contribution by the joint venture parties, the ratio of capital contributions, the stipulations on the assignment of amounts of capital contribution, the ratio of distribution of profits to and bearing of losses by the joint venture parties;
5. The composition, authority and rules of procedure of the board of directors, the terms of office of the directors, and the responsibilities of the chairman and vice-chairman of the board of directors;
6. The setting up of management organs, administrative rules, the responsibilities and methods of appointment and dismissal of the general manager, deputy general managers and other high-level managerial personnel;
7. Principles of the finance, accounting and auditing systems;
8. Dissolution and liquidation; and
9. Procedures for amendment of the articles of association.

⁴³ Supp. No. 4, *supra* note 38, at 7-12.

and the language of the foreign partner(s). Though both languages carry equal importance under the law, the model contract and articles of association recommend that in the event of a discrepancy between the different languages, the Chinese version should prevail.⁴⁴ This implies that foreign investors should not rely only upon the documents in their own language, but should have a clear understanding of the documents in Chinese as well to avoid problems of conflict.

B. Government Control

An examination of Chinese joint venture law and related regulations reveals that the Chinese government exercises broad power in the administration of Sino-foreign joint ventures. China is a planned-commodity economic system in which the government is accustomed to controlling Chinese enterprises very tightly. Though reformers have pushed very hard for decentralization of the economy, since the "open door" policy was adopted, tight centralized control is still clearly reflected in the regulations.

1. *Approval for the Establishment of a Joint Venture*

There are two levels of approval needed for the establishment of joint ventures in China: the provincial authority and the central government authority. According to Chinese law and regulations, however, the ultimate power resides in MOFERT.⁴⁵ Whether a joint venture is approved by MOFERT or by a provincial authority, however, the policy and legal criteria for approval is the same.

Article 3 of the Joint Venture Regulations lists the industries in which joint ventures can be formed. This list includes virtually all industries other than the defense industry.⁴⁶ Article 4 of the JVR spells out the requirements for approval by the Chinese government⁴⁷ and emphasizes that the economic goals of a joint venture are: 1) to increase the variety, quality, and quantity of products; 2) to conserve energy and materials; and 3) to increase foreign exchange earnings. A joint venture will not be approved if it: 1) is detrimental to Chinese sovereignty; 2) violates Chinese law; 3) does not appear to help develop China's national economy; 4) causes pollution; or 5) results in an "obviously unfair" joint

⁴⁴ *Id.*, art. 80, at 12.

⁴⁵ The power of approval over Sino-foreign joint ventures, including extension and termination, was originally vested in the Foreign Investment Commission. Since the merger of that body with three others in 1982, this power has transferred to MOFERT. *See also infra* note 50.

⁴⁶ *See supra* note 13.

⁴⁷ *Id.*

venture agreement, contract, or articles of association.⁴⁸

2. Approval by MOFERT

Within MOFERT, there are two departments that handle the approval of joint venture projects, the Department of Foreign Investment Control and the Department of Treaties and Law. There are no written procedural rules or detailed standards within these departments used to approve joint venture projects. The only standards they follow are those in the Joint Venture Law and Regulations.

The Department of Foreign Investment Control is in charge of "project examination" of proposed joint ventures. This examination assesses the project in accordance with government policy, economic plans, and the requirements as stipulated in Articles 3 and 4, and paragraphs 3 and 4 of Article 5, of the JVR. The Department of Treaties and Law in MOFERT is responsible for examining the legal issues such as those presented in paragraphs 1, 2, and 5 of Article 5 of the Joint Venture Regulations.⁴⁹

Usually if the total investment in a production-oriented joint venture project exceeds \$5 million, final approval must be given by MOFERT. Some large cities, however, may themselves approve projects which exceed this limit. Even if it is within a provincial authority's power to approve a joint venture project, if the project requires the central government to supply energy, raw materials, or transportation, or if the products to be produced fall under state export quotas, the approval power is transferred from the provincial authority to MOFERT.⁵⁰ In any event, the provincial authority must report projects it approves to, and obtain the certificate of approval from, MOFERT.⁵¹

⁴⁸ JVR art. 5.

⁴⁹ See *supra* text accompanying note 48.

⁵⁰ JVR art. 8 stipulates:

The establishment of joint ventures in China must be examined and approved by the Ministry of Foreign Economic Relations and Trade [hereinafter the Ministry of Foreign Economic Relations and Trade]. After approval, the Ministry of Foreign Economic Relations and Trade is to issue a certificate of approval.

In any cases where the following conditions exist, the Ministry of Foreign Economic Relations and Trade must entrust the people's government of the relevant province, autonomous region, or directly-administered municipality or the relevant ministry or bureau of the State Council with examination and approval:

1. The total amount of investment is within the sum stipulated by the State Council and the source of capital of the Chinese participants has already been ascertained; and
2. The additional allocation of raw materials by the State is not required and the national balance in such areas as fuel, power, transportation and foreign trade export quotas is not affected.

⁵¹ *Id.*

3. *Approval by Provincial Authorities*

In the first three or four years after China adopted the "open door" policy, the provincial authorities could approve only those projects with total investments of \$3 to \$5 million.⁵² After this initial period, China instituted a policy advocating decentralization of China's economy. This policy led to the opening of the fourteen coastal cities and Hainan Island to foreign economic interests and a vesting of greater power to approve joint ventures in the provincial authorities. Whether this increased provincial authority⁵³ continues to expand depends upon the future trend of economic reform in China. If the past few years can be taken as an indication of the future, it is likely that the provincial authorities will play increasingly important roles and continue to obtain greater power regarding economic decisionmaking.

Even with the increased provincial discretion, however, final approval for establishment of a joint venture must be given by MOFERT after the provincial authority's preliminary approval. In addition, the State Council and MOFERT have the discretion to decide how much power a provincial authority is allowed. If the project is in a service industry and does not require the central government to supply energy or raw materials, the provincial authorities may currently give approval regardless of the amount of investment involved. Production-oriented joint ventures with a total investment of up to \$5 million may be approved by the open cities on the condition that no energy or raw materials from the central government are required. Some provinces and cities have even greater power to approve production-oriented joint venture projects. Some provincial authorities have further delegated the power of approval with respect to small projects to local county or district authorities.⁵⁴ In this case, foreign investors should establish close relationships with the local officials. These officials have power to approve the project, as well as the resource and distribution networks.⁵⁵

⁵² *Questions and Answers Concerning Foreign Investment in China*, China Econ. News, May 12, 1982, at 3.

⁵³ Shanghai and Tienjing, for example, may approve \$30 million joint venture projects. Liaoning and Guangdong provinces, as well as the Beijing, Guangzhou, Shenyang, and Dalian municipalities, may approve \$10 million production-oriented joint venture projects.

⁵⁴ Beijing municipality delegated to counties, districts, and bureaus the right to approve joint venture projects having total investments of up to \$1 million. See *People's Daily*, Oct. 13, 1986 (overseas Chinese ed.).

⁵⁵ In addition, after a joint venture has been established, approval either from the provincial authority or MOFERT is necessary in the event that the project contains: 1) amendments to the joint venture agreement, contract or articles of association, JVR art. 17; 2) a party's assignment of its capital contribution to a third party, JVR art. 23; 3) "[t]he increase, assignment or disposition by other means of the registered capital of" a joint venture, JVR art. 24; 4) the establishment of an

C. Capitalization of a Joint Venture

The required ratio of equity participation in a Sino-foreign joint venture is flexible. China did not adopt the standard 51%-49% foreign investment formula of other developing countries. The only requirement for a foreign investor's capital contribution in China is that it not be less than 25% of the total investment in a joint venture project.⁵⁶ Because there is no maximum amount of foreign investment specified, in theory the range of allowed capital contribution by the foreigner is 25%-99%.⁵⁷

Foreign investors should be especially aware of two restrictions on capital investment under the Joint Venture Law and Regulations. First, Article 22 of the Joint Venture Regulations provides that: "Joint ventures must not reduce their registered capital during their terms." Second, Article 23 of the JVR restricts transferability of shares in a joint venture; if one party to a venture wishes to sell its share to a third party, the other partners in the enterprise have the right to veto the sale under Article 23. Moreover, Article 23 gives preemptory purchase rights to the joint venture partners, and requires that partners wishing to exercise such rights receive terms no less favorable than those offered to a third party.

Capital contributions to a joint venture can be made by either side, in cash or in kind.⁵⁸ A foreign partner usually contributes a significant proportion of its capital contribution through know-how or foreign currency. The Chinese side contributes its capital mainly in the form of machinery, factory buildings, and the rights to the use of sites and other facilities. Article 5 of the Joint Venture Law requires that the technology or equipment contributed by the foreign side be "truly advanced and appropriate to China's needs." Articles 27 and 28 of the Joint Venture Regulations articulate these requirements in more detail.⁵⁹

overseas branch office for a joint venture, including offices in Hong Kong or Macao, JVR art. 42; 5) a technology transfer agreement between it and a foreign company, JVR art. 46; 6) the opening of foreign exchange deposit accounts in banks abroad, or in Hong Kong or Macao (this must also be approved by the State Administration of Foreign Exchange Control or one of its branches), JVR art. 76; 7) "approval of the extension of a joint venture's term," JVR art. 101; 8) the dissolution of a joint venture, JVR art. 102.

⁵⁶ JVL art. 4.

⁵⁷ In 1984 there were 651 Sino-foreign joint ventures in China. Projects in which a majority of the total investment was assumed by Chinese parties accounted for 64% of this total; 27% of the projects had each side contribute 50%; projects in which the majority shares were assumed by foreign investors were around 9%. See *Sino-foreign Joint Ventures Concluded in 1984*, reprinted in INVESTMENT GUIDE, *supra* note 4, at 366-416. Only one Sino-foreign joint venture had a foreign investment of 99%. *Id.* at 403, no. 475. It also appears from the 1984 data that some foreign investors invested less than 25%.

⁵⁸ JVR art. 25.

⁵⁹ Article 27 of the JVR states:

After assessment of all partners' contributions to the joint venture has been made⁶⁰ (excluding valuation of the site), and the amounts of their capital contributions under the contract have been paid, the amount of contribution must be verified by a Chinese registered accountant who then issues a report on verification of capital. The joint venture may subsequently issue certificates of capital contribution.⁶¹ Because of the restrictions on the transfer of shares of a joint venture to third parties,⁶² the certificate of capital contribution can only serve as evidence of the parties' investments.

D. Management

Managerial control of a joint venture company is a basic concern of all the parties because it directly affects their rights and interests in the company. The lack of corporate law in China requires that both sides carefully negotiate control and management of a joint venture. The parties should work out detailed rules regarding the management functions, division of authority, and general procedures of the enterprise. Special care should be taken by the parties to draft rules not spelled out in the Joint Venture Regulations, which the parties believe are necessary for the success of the joint venture. The Joint Venture Law and Regulations contain two tiers of management organs—the board of directors and the business management office. The board of directors is the highest authority in a joint venture.⁶³ It must have three or more directors, the chairman of which must be appointed by the Chinese partner. The vice chairman is appointed by the foreign participants.⁶⁴

The machinery, equipment or other materials contributed by foreign participants in a joint venture as capital contributions must meet all of the following conditions:

1. They must be indispensable to the joint venture's productions;
2. They must be items that China cannot produce, or, although China can produce them, the prices are overly high or the items are unable to guarantee the meeting of requirements with respect to technical function or time of supply. . . .

With respect to industrial property rights and know-how, the foreign side must contribute knowledge that: 1) enables China to produce needed new products, or products suitable for export; 2) improves the function and quality of existing Chinese products and raises productivity; or 3) saves "raw materials, fuel, or power." JVR art. 28.

⁶⁰ "[V]aluation is to be discussed and determined by the joint venture parties in accordance with the principles of fairness and reasonableness, or a third party agreed upon by the joint venture parties is to be retained to make an assessment." JVR art. 25.

⁶¹ JVR art. 32. The certificate of capital contribution includes "the names of the joint venturing entities or individuals, the amounts of their capital contributions and the day, month and year of the capital contributions, and the day, month and year of issuance of the certificates of capital contribution." *Id.*

⁶² See *supra* text accompanying notes 57-58.

⁶³ JVR art. 33.

⁶⁴ JVL art. 6; JVR art. 34.

The term of office for directors is four years and is renewable. Article 34 of the Joint Venture Regulations provides that "the distribution of the number of directors is to be determined by discussion between the joint venture parties by reference to the ratio of capital contributions."⁶⁵ The board must meet at least once a year, generally at the location of the joint venture's legal address.⁶⁶ The meeting is valid only if more than two-thirds of the directors are in attendance.

The board of directors is empowered to decide all the fundamental issues of the joint venture in accordance with the joint venture contract, the articles of association, and the Chinese Joint Venture Law and Regulations. Under the Joint Venture Regulations, a unanimous vote of the directors in attendance is needed to amend the articles of association, terminate or dissolve the joint venture, increase or assign the registered capital, or merge the joint venture with another economic association.⁶⁷ Additional items requiring a unanimous vote may be written into the articles of association through negotiation. Examples of such items might include budgetary matters, distribution of profits, changes in pricing, sourcing of raw materials, granting of subcontracts, indebtedness, appointment of key managerial personnel, new product development, potential ventures with third parties, and export sales.⁶⁸

Neither the JVL nor the JVR identifies issues which might require a super or simple majority vote.⁶⁹ These items should be explicitly stipulated in the contract by the parties according to their needs. The importance of these issues to minority shareholders should not be understated, since their interest in the joint venture may be adversely harmed if special voting rights are included and abused by the majority. The minority parties should carefully review which items can be decided by only simple majority vote. For further protection of minority interests, super majority votes or minority veto rights⁷⁰ may be written into the joint venture contract and the articles of association.

⁶⁵ There is a difference between the Joint Venture Law and Regulations in this particular provision; Article 6 of the JVL does not mention the ratio of the parties' capital contributions with respect to appointment of directors. By adding this requirement, the Regulations improved the opportunity for the majority investor to protect its interest in the venture.

⁶⁶ JVR art. 35.

⁶⁷ JVR art. 36.

⁶⁸ Surrey, *Joint Ventures in China: The First Water Stop* 21 TEX. INT'L L.J. 233 (1986). See also Hendryx, *Implementation of a Technology Transfer Joint Venture in the People's Republic of China: A Management Perspective* 21 COLUM. J. WORLD BUS. 59 (1986).

⁶⁹ See Joint Venture Model Contract, *supra* note 38, art. 27; Joint Venture Model Articles of Association, *supra* note 38, art. 30.

⁷⁰ Rich, *Joint Venture in China: The Legal Challenge*, 15 INT'L LAW. 200 n.169 (1981). See generally Surrey, *supra* note 68.

One important issue which concerns foreign participants is that the chairman of the board of directors is appointed by the Chinese party, regardless of the ratio of the capital contributions of the parties. However, aside from those functions of the chairman stipulated in the regulations—legally representing the joint venture, and calling and presiding over the board meetings—the chairman's powers are not clear. Foreign investors worried that a Chinese chairman might dilute their control of a joint venture in which they hold a majority interest would be wise to articulate the chairman's other functions and rights. Issues such as veto power and the procedures for decision-making by the board should be placed in both the joint venture contract and the articles of association.

Article 38 of the JVR requires the establishment of a management office (with a general manager and deputies) to implement the various policies of the board of directors and direct the daily operations of the joint venture. The general manager and deputy general managers retained by the board may be either Chinese or foreign. The chairman and vice chairman of the board of directors are eligible for any high-level managerial positions in the venture.⁷¹

The general manager, within the scope of his power as defined by the board of directors, represents the joint venture in its external affairs. Internally, he has the right to appoint and dismiss subordinate personnel, as well as exercise power over other responsibilities as authorized by the board of directors. General managers and deputy general managers may not hold similar managerial positions in other enterprises concurrent to serving in the joint venture.⁷²

On October 11, 1986, the State Council of China promulgated new provisions to further encourage foreign investment.⁷³ Article 15 of the new provisions stipulates that China will "safeguard the right of autonomy of Enterprises with Foreign Investment" and will support such enterprises "in managing themselves in accordance with international advanced scientific methods."⁷⁴ Included within this autonomy are the rights of enterprises with foreign investment to determine production and operation plans, to raise and use funds, to purchase production materials, to sell products, and to determine the forms and levels of remuneration.

Article 15 also provides that enterprises with foreign investment may, in accordance with their production and operation requirements,

⁷¹ JVR art. 40.

⁷² JVR arts. 39-40.

⁷³ Provisions of the State Council for the Encouragement of Foreign Investment, promulgated Oct. 11, 1986, *reprinted in* 14 CHINA BUS. REV. 14 (Jan.-Feb. 1987) [hereinafter the 22 Provs.].

⁷⁴ The term "enterprises with foreign investment" refers to Sino-foreign equity joint ventures, Sino-foreign contractual ventures and wholly-foreign owned enterprises.

determine their organizational structure and personnel system, employ or dismiss senior management personnel, and increase or decrease staff and workers. Within the scope of this power, such enterprises may recruit and employ technical and managerial personnel, as well as workers in the joint venture's locale.⁷⁵ Another aspect of economic autonomy for foreign businesses is seen in the reduced protection employees have under Article 15 of the new provisions; staff and workers who violate the rules of a foreign investment enterprise are subject to various penalties, including discharge, depending on the seriousness of their offenses.

Article 19 of the new provisions provides that the new rules are to be applicable to all enterprises with foreign investment. Those provisions of the Joint Venture Regulations specific to labor management which conflict with the new provisions are therefore superceded. Although Sino-foreign joint ventures may still face some obstacles in exercising autonomy over the management of their own businesses, in practice these obstacles should largely be eliminated following the implementation of the new provisions.

E. Acquisition of Technology

Acquisition of technology from outside the PRC was controlled solely by Chapter VI of the Joint Venture Regulations from 1983 until 1985. Since 1985, three separate bodies of rules have been promulgated to govern acquisition of technology: the Foreign Economic Contract Law; the Regulations of the People's Republic of China on the Administration of Technology Acquisition Contracts ("Technology Regulations");⁷⁶ and the Procedures for the Examination and Approval of Technology Import Contracts ("Technology Procedures").⁷⁷ These laws and regulations apply to all technology transfer agreements, except those in which foreigners contribute technology as part of their share of capital to the joint venture.⁷⁸ Such foreign investors are to receive a continuing return from their investment of technology in the form of a share of profits obtained from the sale of the joint venture-made products.

1. *Concept and Scope of Technology Importation*

Under the Technology Regulations, importation of technology re-

⁷⁵ The economic unit employing such recruits is required to permit their transfer, as well as provide support to the enterprise. The 22 Provs., art. 15.

⁷⁶ See *supra* note 23.

⁷⁷ Procedures for the Examination and Approval of Technology Import Contracts, *reprinted in* China L. Foreign Bus. (CCH Austl.) ¶ 6690 (1985) [hereinafter Tech. Procs.].

⁷⁸ See JVR arts. 27-30.

fers to the acquisition of technology through trade or economic and technical cooperation between a Chinese recipient and a foreign supplier. Foreign partners in a Sino-foreign joint venture are considered foreign suppliers for this purpose.⁷⁹

The technology import contracts which must go through the formalities of governmental examination and approval include contracts for: 1) the transfer or licensing of industrial property rights or know-how; 2) technical services, including feasibility studies or engineering design, geological exploration, renovation of enterprises, improvement of production technology or product design, quality control, and enterprise management; 3) cooperative production; 4) the supply of complete sets of equipment involving the transfer or licensing of industrial rights, or the provision of technical services; and 5) the transfer or licensing of industrial rights or the provision of technical services.⁸⁰

2. Prohibitive Conditions and Guarantee Clauses

Article 9 of the Technology Regulations contains nine subprovisions which prohibit restrictive conditions imposed on Chinese recipients of technology by foreign suppliers, except when otherwise approved by the appropriate Chinese authority. A technology transfer contract containing one of the following conditions must be modified or receive special approval:

- 1) The Chinese recipient is required to accept conditions unrelated to the technology being imported. Examples include required purchases of unnecessary technology, technical service, raw materials, equipment and products;
- 2) The Chinese recipient's freedom to obtain raw materials, parts, and components from other sources is restricted by foreign suppliers;
- 3) The recipient's freedom to develop and improve the imported technology is restricted;
- 4) The recipient's freedom to obtain similar or competitive technology from other sources is restricted;
- 5) Non-reciprocal terms for the exchange of improvements to the technology are written in the contract;
- 6) The foreign suppliers restrict quantity, variety, or sale price of products manufactured by the recipient of the imported technology;
- 7) Foreign suppliers unreasonably restrict the sale channels and export markets of the recipient;

⁷⁹ Tech. Regs., art. 2. *See also* Tech. Procs., art. 3.

⁸⁰ Tech. Procs., art. 2.

- 8) Foreign suppliers prohibit the recipient from using the imported technology after expiration of the contract;
- 9) The Chinese recipient is required to respect unused or expired patents.

Article 46 of the Joint Venture Regulations sets forth conditions for both parties to technology transfer agreements. In addition to the requirements laid down in Article 9 of the Technology Regulations, a technology transfer agreement must meet three specific conditions. First, the fees for the use of technology must be fair and reasonable. Royalties should generally be used as payment and should not exceed the standard international levels. Second, the term of a technology transfer agreement should be ten years or less.⁸¹ Lastly, the agreement must not contain any of the restrictive clauses prohibited by the Joint Venture Regulations.⁸² The Technology Regulations also require that the licensor be the lawful owner of the technology and that the technology provided be complete, correct, effective, and capable of accomplishing the technical goals specified in the contract.⁸³

The transfer agreement requirements illustrate the Chinese government's sensitivity to restrictive terms and intention to protect Chinese licensees from deception by foreign licensors. From the perspective of foreign licensors, however, these rules can be aggravating. By prohibiting imposition of terms designed to ensure quality control, the licensor's interest in a product's quality cannot be protected either in the contract or in the relevant Chinese law.⁸⁴ This absence of basic quality control measures is detrimental to both the licensor and the licensee. In order to create a successful technology transfer business and maintain the reputation of a particular product, the licensor should be able to exercise reasonable and effective control of product quality. The lack of such a right under Chinese law may discourage foreign licensors from dealing in China and could cause difficulty in negotiating quality control clauses in agreements with Chinese recipients. Because the Chinese laws and regulations in this area are still very general, the Chinese authority has great discretion in approving innovative transfer agreements between Chinese

⁸¹ The ten-year limit for the term of a technology import contract should not be understood to be mandatory. If the contract must extend beyond ten years, however, it requires special approval. Tech. Regs., art. 8. Approval issues from the relevant authority of the Chinese government. Tech. Procs., art. 10.

⁸² JVR art. 46.

⁸³ Tech. Regs., art. 6. *See also* JVR art. 44.

⁸⁴ A foreign licensor is, however, entitled to fair and reasonable fees for the use of its technology. JVR art. 46. In addition, the licensor can require its Chinese licensee to keep technical secrets confidential during the term of the contract. Tech. Regs., art. 7.

and foreign parties. The adoption of general open provisions in transfer contracts—such as “unless otherwise agreed upon by both parties” and “unless specially approved by the approving authority”—might give both sides some leeway in negotiating quality control mechanisms if the approving authority took an encouraging attitude towards quality control. Such an attitude is necessary if China wishes to attract more advanced technology to China through the vehicle of the technology transfer contract.

3. *Approval of Technology Import Contracts*

A technology import contract concluded between a joint venture and the foreign investor's original company or a third party must be examined and approved by MOFERT or the local department designated by MOFERT. An application for the approval of a contract should be submitted by the Chinese recipient to the approving authority within thirty days of the contract's conclusion.⁸⁵ The approving authority must render a decision on the application within sixty days from the date of receipt. If no decision is made within this period, the contract can be regarded as approved and will come into effect automatically.⁸⁶

During the approval process, the factors set out in Article 6 of the Technology Procedures will be considered by the authorities.⁸⁷ Most of the factors overlap or restate requirements set out in the Technology Regulations and JVR. According to Article 6, the basic contractual provisions of a technology transfer agreement must be complete and appropriate, and must contain clear and reasonable provisions governing the property rights of the transferred technology and the liabilities and procedures in the event of a dispute. The contract must have reasonable technical standards for the transferred technology, including a guarantee by the transferor of the quality of the products produced with the technology. The price and payment terms under the contract must be reasonable, and the rights, responsibilities, and obligations of the contracting parties must be clear, reciprocal, and reasonable. If the contract contains preferential tax treatment, it must have been approved by the tax authorities. Finally, there must be no contractual provisions which violate Chinese law or harm China's sovereignty.

Once a technology import contract is approved, the approving au-

⁸⁵ To obtain approval of a technology import contract, an applicant must submit a written application, a copy of the contract, and documents disclosing the legal status of the parties concerned. Tech. Regs., art. 9.

⁸⁶ Tech. Regs., art. 4.

⁸⁷ These factors are based upon the authority of the Tech. Regs., art. 4.

thority will issue the "Approval Certificate for a Technology Import Contract," printed and numbered by MOFERT.⁸⁸ If a contract is not approved, the approving authority will usually cite its reasons for rejection so that the parties may negotiate the appropriate changes. To avoid such problems the Chinese recipient, either before or during the negotiation of a technology import contract, may consult the approving authority on contractual terms or submit the contract for preliminary examination.⁸⁹

4. Taxation of Technology Import

According to the Foreign Enterprise Income Tax⁹⁰ and its Detailed Rules and Regulations,⁹¹ a foreign licensor having no establishment in China must pay a 20% income tax to the Chinese government on income from royalties obtained from China. Such royalties include income derived from the provision of patents, technical know-how, copyrights, and trademark interests for use in China.⁹²

To encourage foreign companies to provide China with advanced technology and know-how, the Ministry of Finance issued the Interim Provisions on Royalties.⁹³ These provisions offer certain preferential treatment to foreign companies which can include a 50% reduction, or even a total exemption from, the income tax on royalties.⁹⁴

When a particular technology provided by foreign licensors qualifies

⁸⁸ The Approval Certificate is an important instrument and will be needed by the joint venture recipient for arranging bank guarantees, letters of credit, payments, customs clearances, payment of taxes, and applications for reduction of, or exemption from, taxes or duties. Tech. Procs., art. 10.

⁸⁹ Tech. Procs., art. 7.

⁹⁰ Income Tax Law Concerning Foreign Enterprises, adopted Dec. 13, 1981 [hereinafter FEIT], reprinted in INVESTMENT GUIDE, *supra* note 4, at 521.

⁹¹ Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China Concerning Foreign Enterprises, promulgated on Feb. 21, 1982 [hereinafter FEIT Regs.], reprinted in INVESTMENT GUIDE, *supra* note 4, at 523.

⁹² FEIT art. 11; FEIT Regs., art. 27.

⁹³ Interim Provisions of the Ministry of Finance Concerning the Reduction of or Exemption from Income Tax on Royalties for Proprietary Technology [hereinafter Interim Provisions on Royalties], reprinted in INVESTMENT GUIDE, *supra* note 4, at 532.

⁹⁴ There are five categories which may be eligible for the exemptions or reductions of income tax derived from royalty tax: 1) technology for the development of farming, forestry, fishery and animal husbandry; 2) technology for scientific research; technology for the development of China's energy, communication, or transportation fields and for the construction of China's key projects; 3) technology for the conservation of energy, and the prevention and control of environmental pollution; 4) technologies for developing China's major and advanced mechanical and electrical equipment and nuclear equipment; 5) technology for large-scale integrated circuits, photoelectric integrated circuits, microwave semi-conductors, microwave integrated circuits, microwave electronic tubes, ultra-high speed electronic computers, microprocessors, photoconductor communications, long-distance, ultra-high voltage direct current power transmission, liquidation, gasification and comprehensive utilization of coal. Interim Provisions on Royalties, art. 1(a-e).

for tax benefits, the Chinese recipient should submit all relevant documents, information, and comments made by the approving authority to the local tax authority for examination and determination. In the case of a total exemption, the local tax authority must examine the case carefully, consult with other local authorities, and submit the documents and relevant opinions to MOFERT for approval.⁹⁵

According to Article 11 of the Foreign Enterprise Income Tax, the Chinese recipient of the foreign technology acts as the withholding tax agent for the foreign licensor. Taxes on each royalty payment must be turned over directly to the State Treasury by the licensor within five days after the end of each quarter.

F. Financial and Accounting Management

Joint venture parties must establish their financial and accounting systems pursuant to Chinese law and notify the local financial and tax departments of their choice.⁹⁶ The accrual system and debit/credit system are valid accounting systems under the Joint Venture Regulations. All vouchers, account books, and statements must be written in Chinese, but can be written in another foreign language as agreed upon by the parties.⁹⁷

An accountant and an auditor are required for all joint ventures, unless the joint venture is a small one. The accountant assists the general manager in conducting financial and accounting work; the auditor is responsible for the general accounts, including the examination and checking of financial receipts and disbursements and submission of financial reports to the board of directors and general manager.⁹⁸

A joint venture's fiscal year runs from January 1 to December 31. In principle, joint venture parties should use Chinese currency, renminbi yuan, as the accounting standard. A foreign currency, however, may be adopted as the standard if agreed upon by the parties.⁹⁹ In addition to the currency of accounting, any cash, bank deposits, disbursements, and obligations or expenses enumerated in currencies other than the standard must be recorded as well.

Article 87 of the Joint Venture Regulations governs profit distribution by the Sino-foreign enterprise. The procedures and principles are

⁹⁵ Interim Provisions on Royalties, art. 3.

⁹⁶ JVR art. 80.

⁹⁷ JVR art. 84.

⁹⁸ JVR arts. 81-82.

⁹⁹ In this case, the joint venture must prepare accounting statements in both Chinese and foreign currency. JVR art. 86.

quite similar to the laws of western companies. After paying income tax,¹⁰⁰ reserve funds to offset previous losses or increase capital, employee benefits, and enterprise expansion funds are allocated by the board of directors from the firm's revenues. The board may then distribute the profits to the joint venture parties (including any previous year's undistributed profits) in accordance with the ratio of their relative capital contributions.¹⁰¹

The joint venture parties are also required to file their quarterly and annual accounting statements to the local tax bureau, the local financial department, and the department in charge of joint ventures in the same locality.¹⁰² In addition, the annual accounting statements must be submitted to the authority which originally approved of the joint venture project and verified by a Chinese registered accountant.¹⁰³

G. Taxation and Customs Duties

1. Corporate Income Tax Law

a. Tax rates

According to the Income Tax Law Concerning Joint Ventures Using Chinese and Foreign Investment (the "JVIT"),¹⁰⁴ joint venture parties are obligated to pay income tax on the worldwide net income of the venture derived from production, business, and other sources.¹⁰⁵ The rate of income tax is 33%—calculated as a 30% national tax with a 10% local surtax on the national base.¹⁰⁶ When a foreign participant remits its share of profits outside China, a tax of 10% is levied on the remittance.¹⁰⁷

¹⁰⁰ See *infra* notes 104-127 and accompanying text.

¹⁰¹ JVR arts. 87-88.

¹⁰² JVR art. 89.

¹⁰³ *Id.* The accountant should then issue a certificate of verification of the joint venture.

¹⁰⁴ Income Tax Law Concerning Joint Ventures with Chinese and Foreign Investment, adopted Sept. 10, 1980 [hereinafter JVIT], reprinted in INVESTMENT GUIDE, *supra* note 4, at 510.

¹⁰⁵ Production and business income is derived "from the production and business operations in industry, mining, communications, transportation, agriculture, forestry, animal husbandry, fisheries, poultry farming, commerce, tourism, catering service and other trades." Detailed Rules and Regulations for the Implementation of the JVIT, art. 2, promulgated Dec. 14, 1980 [hereinafter JVIT Regs.], reprinted in INVESTMENT GUIDE, *supra* note 4, at 512.

Income from "other sources" covers "dividends, bonuses, interest and income from lease or transfer of property, patents, technical know-how, trade mark interests, copyright and other items." *Id.*

¹⁰⁶ JVIT art. 3. The calculation of income tax on joint ventures is based on general accounting practices, i.e., taxable income equals sales income minus cost of sales minus sales expenses, nonbusiness expenditures or nonbusiness income.

¹⁰⁷ JVIT art. 4.

b. Preferential income tax treatment

The Chinese government offers several other forms of preferential tax treatment to attract foreign investors, in addition to the tax benefits for the advanced technology transfer.

First, a newly-established joint venture planning to operate over ten years may, upon approval by the Chinese tax authority, be exempted from income tax in the first and second profitmaking years, and receive a 50% reduction of its income tax in the third, fourth, and fifth years.¹⁰⁸ Second, a joint venture engaged in low profit operations such as farming and forestry, or located in remote, economically underdeveloped areas, may be allowed a 15%-30% reduction in income tax for ten years after expiration of the benefits in the first paragraph of article 5 of the JVIT. Third, a foreign participant which reinvests its share of profits in China for a period of not less than five years may, upon the approval of the tax authority, obtain a rebate of 40% of the income tax paid on the reinvested amounts. If the foreigner withdraws the funds earlier, the amount of refunded tax must be repaid.¹⁰⁹ Finally, losses incurred in a joint venture in any one tax year may be carried over to the next tax year and made up by a matching amount drawn from that year's income. If the following year's income is still not sufficient to cover the losses, the balance can be made up during the next year. Such carry-over cannot exceed a period of five years.¹¹⁰

c. Time for withholdings, tax returns, and penalties

Joint venture income tax is calculated on an annual basis and requires prepayment in quarterly installments, within fifteen days following the end of each quarter. Payment may be calculated as one-quarter of the planned annual profits for the current year or the actual income in the preceding year.¹¹¹ A joint venture's income tax return, together with its final financial statements, should be filed with the local tax authority within four months following the end of each tax year for final income tax settlement. Any excess payment will be refunded by the tax authority and any deficiency must be made up by the taxpayer. Final settlement must be made within five months following the end of each tax

¹⁰⁸ The original art. 5 of the JVIT only offered an income tax exemption in the first year of profit and a 50 percent reduction in the second and third profit-making years of a joint venture operating over ten years. The JVIT was revised at the Second Meeting of the Standing Committee of the Sixth National People's Congress on September 2, 1983. See Appendix: Revision of the JVIT art. 1, reprinted in INVESTMENT GUIDE, *supra* note 4, at 512.

¹⁰⁹ JVIT art. 6.

¹¹⁰ JVIT art. 7.

¹¹¹ JVIT art. 8; JVIT Regs., art. 19.

year.¹¹²

The Chinese tax authorities have the right to impose a penalty of up to 5,000 yuan (\$1,348) if a joint venture has violated the provisions of article 9 (tax return requirements), Article 11 (requirements for registration of the joint venture, business and address changes, winding up, and changes or assignments of registered capital) or Article 12 (tax authorities' right to investigate the financial affairs of a joint venture).¹¹³ Joint venture parties that have failed to keep accounting books, vouchers, statements, and reports for fifteen years, or that have used invoice forms or business receipts without prior approval by the local tax authorities, may also be fined up to 5,000 yuan.¹¹⁴

2. Individual Income Tax

Pursuant to Article 70 of the Joint Venture Regulations, foreign staff members and workers in a joint venture must pay individual income taxes in accordance with the Individual Income Tax.¹¹⁵ Foreign individuals not residing in China, or residing in China for less than one year, will be taxed on the income earned in China.¹¹⁶ If they reside in China for more than one year, but less than five years, they will be taxed upon income earned in China and income earned elsewhere and remitted to China.¹¹⁷ If a person is resident in China over five years, income tax must be paid on overall income regardless of whether or not it was earned in, or remitted to China.¹¹⁸

Income under the Individual Income Tax includes wages and salaries, compensation for personal services, royalties, interest, dividends and bonuses, income from lease of property, and other items specified by the Ministry of Finance. Income from wages and salaries in excess of a specified amount will be taxed at progressive rates ranging from five percent to 45%.¹¹⁹ The other categories of income besides wages will be taxed at a flat rate of 20%.

Paragraph 2 of Article 1 of the JVIT states that the income derived from branches or subsidiaries of a joint venture located outside China

¹¹² JVIT arts. 8-9; JVIT App., arts. 2-3.

¹¹³ JVIT Regs., art. 28. *See generally* JVIT App.

¹¹⁴ JVIT Regs., art. 29.

¹¹⁵ Individual Income Tax Law, adopted Sept. 10, 1980 [hereinafter IIT], with Detailed Rules and Regulations, promulgated on Dec. 14, 1980 [hereinafter IIT Regs.]. *See generally* Easson & Li, *supra* note 11, at 683-92.

¹¹⁶ IIT art. 1.

¹¹⁷ IIT Regs., art. 3.

¹¹⁸ *Id.*

¹¹⁹ IIT arts. 2-3.

will be paid by the Chinese head office. To avoid the double taxation problems arising from this practice, Article 16 of the JVIT and Article 32 of the Detailed Rules and Regulations for the Implementation of the JVIT (the "JVIT Regulations") grant tax credits for the amount of income tax to be paid by the head office or its branches. This credit cannot "exceed the tax payable on the income received abroad computed according to the tax rate prescribed" by the JVIT.¹²⁰ This problem might be resolved by tax agreements concluded between China and foreign countries.¹²¹

3. *Customs Duties and Consolidated Industrial and Commercial Taxes*

According to the Consolidated Industrial and Commercial Tax (the "CICT"),¹²² "[a]ll units or individuals engaged in the production of industrial products, the purchase of agricultural products, the importation of foreign goods, commercial retailing, communications and transportation and all other service trades," must pay the CICT.¹²³ Under these regulations, there are 105 items and 136 rates applicable to industrial and farm products, and five CICT rates for retail trade, communication, and transportation. All goods permitted to be imported or exported are additionally subject to border duties, collected by the Chinese Customs Service in accordance with the Customs Import and Export Tariff of the PRC.¹²⁴

In order to encourage foreign investment, however, Sino-foreign joint ventures are exempt from paying both the CICT and import duties on machinery, equipment, parts, and other materials: 1) serving as capital contribution by foreign participants to a joint venture; 2) imported by a joint venture within its total amount of investment; or 3) imported by joint ventures with additional capital after approval by Chinese authorities, because of no domestic production of the products or a shortage of supply in China.¹²⁵ In addition, raw materials, auxiliary materials, components, parts and packaging materials imported by joint ventures for export production are also exempt from the CICT and the customs du-

¹²⁰ JVIT art. 32.

¹²¹ See generally Easson & Li, *supra* note 11, at 693-94.

¹²² Consolidated Industrial and Commercial Tax Law, promulgated Sept. 13, 1958 [hereinafter CICT], reprinted in INVESTMENT GUIDE, *supra* note 4, at 497. See generally Easson & Li, *supra* note 11, at 668-69.

¹²³ CICT art. 2.

¹²⁴ Regulations on Import and Export Duties, art. 2, promulgated on Mar. 7, 1986, reprinted in INVESTMENT GUIDE, *supra* note 4, at 558.

¹²⁵ JVR art. 71.

ties.¹²⁶ If, however, tax-free products are resold or diverted for use in China, the joint venture must pay tax and duty for them. If a Sino-foreign joint venture experiences difficulties in paying the CICT on products destined for domestic sales, it may apply for a CICT reduction or exemption for a limited period of time.¹²⁷ Export products produced by joint ventures—except for items which are restricted to export by the Chinese government—may also be exempt from CICT.

H. Foreign Exchange

Once a joint venture has received its business license, it must open separate foreign exchange and Chinese currency accounts with the Bank of China (the “BOC”) or another bank designated by the BOC. The bank where the account is opened will supervise receipts and disbursements of the joint venture. All foreign exchange income and outlay must use the foreign exchange account.¹²⁸

Article 75 of the Joint Venture Regulations requires a joint venture to maintain a balance between its foreign exchange receipts and disbursements. Under those circumstances where a foreign exchange account cannot be balanced, the relevant Chinese authority may provide an adjustment from its own foreign exchange reserves. There is no guarantee, however, that the authority will be willing to supply foreign exchange to a joint venture lacking foreign currency, due to the shortage of China’s foreign exchange reserves.¹²⁹ Accordingly, venture partners should determine well in advance the distribution of their products between the Chinese market and the export market. In addition, a joint venture should ensure that its foreign exchange earnings will be able to cover the repatriation of foreign investors’ profits, salaries of foreign employees, and import expenditures for machinery, equipment, and raw materials. Alternatively, the venture should make certain that the relevant Chinese authority will reconcile the imbalance. A joint venture may also borrow foreign currency and renminbi from the BOC for self-liquidating loans, financing of accounts, and long-term investment.¹³⁰ There are several

¹²⁶ *Id.*

¹²⁷ JVR art. 72.

¹²⁸ JVR art. 74.

¹²⁹ “One of the most difficult issues faced by joint ventures is foreign exchange balance. The Chinese renminbi is a non-convertible currency and the Chinese government, except in rare cases, will not convert the foreign partners’ earnings to foreign exchange to permit remittance of earnings. In fact the generating of foreign exchange is one of the Chinese motives for joint ventures: they view joint ventures as a source, not a drain of foreign exchange.” Hendryx, *supra* note 68, at 58.

¹³⁰ Provisional Regulations for Providing Loans to Joint Ventures Using Chinese and Foreign Investment by the Bank of China, art. 3, promulgated Mar. 13, 1981 [hereinafter JV Loan Regs.], reprinted in INVESTMENT GUIDE, *supra* note 4, at 479.

requirements for borrowing money from the BOC. Most basically, an applicant must be willing to be bound by Chinese law. In addition, the borrower must open a deposit account with the BOC, maintain a good credit standing and sound management, demonstrate that it has sufficient resources to repay the loan and interest, and provide security or a bond acceptable to the bank as collateral.¹³¹ Moreover, joint ventures which borrow money from the bank are required to allow the bank to monitor the use of the loan and to report to the bank on production, marketing, finance and capital construction.

Additionally, a written loan agreement between the borrower and the bank is required.¹³² If the joint venture breaches the loan agreement, the bank may suspend or recall the loan before maturity.¹³³ Funds may also be borrowed directly from foreign banks, though the joint venture must file a report with the State Administration of Exchange Control (the "SAEC") if a foreign loan is taken.¹³⁴

Remittance of salaries by foreign employees also raises foreign exchange control issues. The law in China is far from clear. Article 79 of the Joint Venture Regulations provides that foreign staff and workers can apply to the BOC to remit legitimate after-tax income out of China.¹³⁵ Under the Provisional Regulations on Foreign Exchange Control (the "Foreign Exchange Regulations"), however, there is a clear constraint upon repatriation of over 50% of a foreign employee's post-tax earnings.¹³⁶ The Rules for the Implementation of the Foreign Exchange Regulations ("Foreign Exchange Rules") further confuse the issue. These more recent provisions require foreign staff and workers to apply to the SAEC in order to remit over 50% of their wages and other earnings.¹³⁷ Because it is unclear what standards the SAEC uses to assess claims for remittance of the foreign staff and workers' wages, and since the SAEC may at any time prohibit such outflows of currency, foreigners have legitimate cause to worry about the SAEC's great discretion.

Overall, the discrepancies among these statutory provisions should be resolved in order to put foreign employees of a joint venture at ease.

¹³¹ JV Loan Regs., art. 4.

¹³² JV Loan Regs., art. 7.

¹³³ JV Loan Regs., art. 9.

¹³⁴ JVR art. 78.

¹³⁵ JVR art. 79.

¹³⁶ Provisional Regulations on Foreign Exchange Control, art. 25, promulgated Dec. 18, 1980, reprinted in INVESTMENT GUIDE, *supra* note 4, at 589.

¹³⁷ Rules for the Implementation of the Foreign Exchange Regs., art. 15, promulgated Aug. 1, 1983 [hereinafter Foreign Exchange Rules], reprinted in INVESTMENT GUIDE, *supra* note 4, at 601.

The standards under Article 79 of the Joint Venture Regulations are more reasonable and more recent and provide the best standards to date.

Foreign investors are also governed by exchange controls. They may remit net profits and other legitimate earnings after taxes by submitting a report on profit distribution and documentary evidence showing that all taxes are being duly paid. The documents are submitted to the foreign investors's Chinese bank and payment is made from the investor's accounts with the bank.¹³⁸ A joint venture also may transfer its foreign capital abroad with the permission of the SAEC or its branch offices.¹³⁹ All of a joint venture's foreign exchange outflows, such as importing of machinery, parts and raw materials, remittance of salaries, profits and other legitimate earnings, and the transfer of foreign exchange capital abroad, will be debited from the foreign exchange deposit account initially opened by the joint venture with the BOC or its designate.

I. Duration, Dissolution, and Liquidation

The duration of a joint venture can be tied by the parties to that of the particular project for which the joint venture is organized. For most projects this is usually from ten to thirty years. Joint ventures with large investments, long periods of construction, and low rates of capital return may have terms ranging from thirty to fifty years in duration.¹⁴⁰ When the joint venture parties agree to extend the term of their cooperation, they must apply to the approving authority for an extension six months before the previous date of expiration.¹⁴¹ If the extension is approved, the venture must undergo registration with the General Administration for Industry and Commerce or its branch office.

A joint venture can also be terminated before its expiration date. Article 102 of the Joint Venture Regulations allows dissolution when there are heavy losses, a party breaches the joint venture contract or articles of association, a *force majeure* occurs, the venture is unable to obtain desired business objectives and its options are limited, or events stipulated by the parties in the joint venture contract or articles of association occur.¹⁴² As always, it is in the parties' interests to spell out the conditions of dissolution clearly in their joint venture contract or articles of association in order to avoid unpredictability and instability during the life of the joint venture. If the termination is caused by a party's breach

¹³⁸ Foreign Exchange Rules, art. 13.

¹³⁹ *Id.*

¹⁴⁰ JVR art. 100.

¹⁴¹ JVR art. 101.

¹⁴² JVR art. 102.

of contract, the breaching party will be responsible for the losses suffered by the other side.

To terminate a joint venture formally, an application for termination must be submitted to the approving authority. Upon dissolution, the board of directors should work out the procedures and principles for liquidation, appoint individuals to a liquidation committee and report these matters to the Chinese authority supervising the liquidation—the government department which normally regulates the enterprise.¹⁴³ The liquidation committee is the legal representative of a joint venture in lawsuits during the period of liquidation, and is normally composed of the joint venture's directors. Chinese registered accountants or lawyers may be invited to be on the committee if the directors cannot serve or are unsuitable to serve.¹⁴⁴ Under Article 105 of the JVR, the liquidation committee has many tasks: inspecting the joint venture's property, debts and creditors' claims; preparing a statement of assets and liabilities and a list of property; appraising the property; designing a liquidation plan; submitting the foregoing to the board of directors; and implementing all necessary measures after adoption.

Should it be necessary, the venture's property can only be distributed in proportion to the ratio of capital contribution by the joint venture parties or consistent with the contract stipulations. Distribution can occur only after settlement of the joint venture's debts. A liquidated joint venture's debt will be limited to its total assets.¹⁴⁵ If the net value of remaining assets of the dissolving joint venture exceeds its registered capital, the surplus will be regarded as profit, and taxes will be levied accordingly.¹⁴⁶

A major issue that may concern foreign investors during dissolution is how to appraise the venture's property, and whether the good will of the joint venture should be considered in valuation. The Chinese law and regulations do not touch on this issue; thus, foreign investors should include clauses addressing this problem in their joint venture contract and articles of association.¹⁴⁷ Chinese law is also silent concerning how quickly the funds from a dissolved operation (after payment of debt capital) can be remitted from China. To spell this issue out in the joint ven-

¹⁴³ JVR art. 103.

¹⁴⁴ JVR art. 104.

¹⁴⁵ JVR art. 106.

¹⁴⁶ See *supra* notes 105-115 and accompanying text.

¹⁴⁷ If no such issues are addressed in the contract, then the foreign investor should recoup the write-off of the property throughout the lifetime of the joint venture. See, e.g., Lussenberg, *Joint Venture Investment in the People's Republic of China: A Continuing Challenge*, 63 CAN. B.R. 545, 586 (1985).

ture contract may not be sufficient to guarantee repatriation, because this issue is likely to be a question for the Chinese government.¹⁴⁸ It will probably be necessary for the Chinese government to enact further provisions clarifying this problem in order to ease foreign investors' minds.

J. Resolution of Disputes

During the life of the joint venture, disputes may arise between the partners, between a joint venture and a third party (either a company or Chinese enterprise), or between a foreign investor and the Chinese government. In such cases, the Chinese side will almost always prefer to settle the dispute by "amicable consultations" or "mediation." Arbitration is the second preference if the dispute cannot be settled by less adversarial means. Litigation is typically viewed as the last resort.

Disputes arising between the joint venture parties in relation to the interpretation or performance of the joint venture basic documents will be governed by Chinese law.¹⁴⁹ The most relevant laws include the Foreign Economic Contract Law, the Joint Venture Law and Regulations, and the United Nations Convention on Contracts for the International Sale of Goods.¹⁵⁰ If arbitration is chosen, an arbitral tribunal from the defendant's country or a neutral country can be chosen by mutual agreement. Though any designated rules of procedure can be used in arbitration, the Chinese side will probably prefer the disputes to be conducted before the Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade. Regardless of the forum, an arbitration award is final and binding on both sides.¹⁵¹

¹⁴⁸ This issue can be resolved through the conclusion of a bilateral investment protection agreement between China and the country of the foreign investor. In such agreements, the Chinese government normally undertakes the reciprocal obligation of "the unrestricted transfer of their assets and, in particular . . . the proceeds of total or partial liquidation of investments . . ." Agreement for the Reciprocal Promotion and Protection of Investments, June 4, 1984, Belgium-Luxembourg Economic Union-China, art. 5, 24 I.L.M. 538 [hereinafter Belgium-China Investment Agreement]. See also Agreement Concerning the Reciprocal Encouragement and Protection of Investments, May 30, 1984, China-France, art. 5, 24 I.L.M. 550 [hereinafter China-France Investment Agreement]. However, no explicit time limit for the transfer of liquidated assets is stated in these agreements, although income from investment and compensation for expropriation or nationalization must be made "without undue delay." Belgium-Luxembourg-China Treaty, art. 4(3).

¹⁴⁹ Art. 5 of the FECL provides "Contracts signed between the Chinese and overseas parties performed within the territory of China in the form of joint venture . . . shall be governed by the laws of the People's Republic of China."

¹⁵⁰ United Nations Convention on Contracts for the International Sale of Goods, *opened for signature* Apr. 11, 1980, 19 I.L.M. 668 (the Convention will enter into force Jan. 1, 1988, in accordance with art. 99(1) of the Convention). The Chinese government, together with the United States and Italy, submitted letters of ratification on December 11, 1986. As of Jan. 1, 1987, 12 other countries had ratified or acceded to the Convention.

¹⁵¹ China acceded to the United Nations Convention on the Recognition and Enforcement of

If contract disputes arise between a joint venture and another enterprise in China, the Economic Contract Law of China will apply to the contracts at issue, and the disputes may be heard by a Chinese arbitral tribunal or People's Court. If the third party is a foreign company, the choice of law and forum may be written into the contract. If the parties are unable to agree upon the applicable law, the law of the country most closely connected with the contract will be applied.¹⁵²

One particular issue which may arise between foreign investors and the Chinese government is that of expropriation or nationalization of foreign property in China. Although the Chinese government has given foreign investors both political and legal assurances that their investments will be fully protected, many foreigners are still reluctant to invest in China, because they are unsure of the seriousness of China's present "open door" policy. Under the foreign investment protection agreements concluded between China and a number of foreign countries, China may expropriate or nationalize foreign property only "for a public purpose, in a non-discriminatory manner, in accordance with due process of law, and upon payment of compensation."¹⁵³ China has not adopted the "prompt, adequate and effective compensation" formula generally accepted by Western nations. Rather, the PRC agrees to compensate foreign investors for "the value of the property and assets invested on the date immediately preceding the date of expropriation,"¹⁵⁴ or the amount which "reflect[s] the true value of the investment in question."¹⁵⁵ Such compensation must be made "without undue"¹⁵⁶ or "unjustified delay,"¹⁵⁷ in a convertible currency.

Disputes over the amount of compensation due in cases of expropriation, nationalization or other similar measures, should be submitted by the investor to one of two fora. The dispute may be heard in the national court of the territory in which the investment is being made, or in an

Foreign Arbitral Awards (New York Convention), *opened for signature* 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38, in December 1986. This decision was made by the 18th Session of the 5th National People's Congress on Dec. 2, 1986. China has declared that it will only recognize and enforce arbitral awards made by another contracting party within its territory on the basis of reciprocity. Moreover, China abides by the Convention on the condition that the disputes must have arisen from commercial relationships as determined by Chinese law. *See People's Daily*, Dec. 3, 1986, at 1 (overseas Chinese ed.).

¹⁵² Art. 5 of the FECL provides: "The parties to a contract may choose a law applicable in settling disputes arising from the contract. If parties make no such choice, the law of the country most closely related to the contract shall be applied."

¹⁵³ China-France Investment Agreement, art. 4(2).

¹⁵⁴ Belgium-China Investment Agreement, art. 2.

¹⁵⁵ Annex to the France-China Investment Agreement, para. 2.

¹⁵⁶ Belgium-China Investment Agreement, art. 4(2).

¹⁵⁷ China-France Investment Agreement, art. 5.

international ad hoc arbitration tribunal.¹⁵⁸ The applicable law for the arbitral tribunal encompasses the domestic law of the country in which the investment is being made, the provisions of the investment protection agreement, the specific investment arrangement, and the principles of international law generally recognized and adopted by the contracting parties in the relevant investment protection agreement.¹⁵⁹ These bilateral treaties cannot be applied to disputes involving a party from a non-contracting country.

A Sino-United States investment protection agreement is currently under negotiation. Following the conclusion of this agreement, United States investors will have more comprehensive protection for their investments in China and, as a result, will have fewer reservations about investing in China.

V. NEW MEASURES TO ENCOURAGE FOREIGN INVESTMENT

Foreign investors running joint ventures in China have found China still far from a competitive country in which to make investments. High costs, price gouging, unproductive labor, tough foreign exchange control, limited access to domestic markets, and government bureaucracy and red tape have all served to frustrate investment.¹⁶⁰ In addition to these problems, some joint venture companies have had difficulty balancing their foreign exchange accounts. These problems have made many foreign companies spurn investment in China.¹⁶¹ To respond to the complaints of foreigners and to encourage joint ventures in China, the Chinese government promulgated two major regulations last year.¹⁶²

¹⁵⁸ See Belgium-China Investment Agreement, art. 6; China-France Investment Agreement, art. 8.

¹⁵⁹ See, e.g., Protocol to the Belgium-China Investment Agreement, art. 7.

¹⁶⁰ See *Firms Doing Business in China Are Stymied By Cost And Hassles*, Wall St. J., July 17, 1985, at 1, col. 1.

¹⁶¹ Foreign investment was down 42% from the 1985 level during the first nine months of 1986. Sullivan, *The Investment Climate*, 14 CHINA BUS. REV. 8 (Jan.-Feb. 1987).

¹⁶² First, the government issued the Provisions of the State Council on the Question of the Balancing of Foreign Exchange Receipts and Expenditures of Chinese-Foreign Joint Ventures, promulgated on January 15, 1986, reprinted in 15 CHINA BUS. REV. 31 (May-June 1986) [hereinafter JV Foreign Exchange Balance Provs.]. Second, it published the 22 Provs. for the Encouragement of Foreign Investments, *supra* note 73. In addition, the government has issued implementing measures for the 22 Provs.:

- 1) Provisional Measures on Renminbi Loan Secured Foreign Exchange for Enterprises with Foreign Investment, issued on Dec. 12, 1986, by the Bank of China.
- 2) Provisions of the Ministry of Labor and Personnel on the Right of Autonomy of Enterprises with Foreign Investment in the Hiring of Personnel and on Wages—Insurance and Welfare Expenses of Staff and Workers, reprinted in China Econ. News, Dec. 15, 1986, at 7 [hereinafter Insurance & Welfare Provs.].
- 3) Customs Procedures for the Administration of Materials and Parts that Enterprises with For-

Moreover, following the promulgation of the two national regulations aimed at attracting foreign investors, many provincial and local governments have issued their own regulations that offer even more favorable conditions for investing in their respective territories. Because this part of the article will only examine the new central government regulations, foreign investors should consult their attorneys to determine what special treatment is offered under provisional or local laws and regulations.

A. Measures to Balance Joint Venture Foreign Exchange Accounts

One of the major obstacles faced by joint ventures operating in China has been the difficulty of earning sufficient foreign exchange in order to balance foreign exchange accounts. This shortage is chiefly caused by two factors. First, most Sino-foreign joint ventures must import almost all materials, components, and equipment for production during their first few years of operation. During this initial period, exports may not cover foreign exchange expenditures for necessary imports and the repatriation of foreign investors' profits. Second, the Chinese currency is not freely convertible to other currencies. Thus, even if a joint venture's products have been selling well in the Chinese domestic market, the joint venture may still lack foreign exchange.

The Provisions of the State Council on the Question of the Balancing of Foreign Exchange Receipts and Expenditures of Chinese-Foreign Joint Ventures (the "Foreign Exchange Balance Provisions") provide several new ways for joint ventures to balance their foreign exchange accounts. The following is an analysis of the major points of the new regulations.

1. Readjustment

Article 3 of the Foreign Exchange Balance Provisions provides that if the foreign exchange account of a Sino-foreign joint venture needs foreign exchange to balance, it may be readjusted by a contribution from

eign Investment Need to Import in Order to Perform Product Export Contracts, issued on Nov. 24, 1986, by the Customs General Administration.

4) Provisions on the Purchase and Export of Domestic Products for Foreign Investment Enterprise to Balance Foreign Exchange Accounts, issued on Jan. 20, 1986, by MOFERT.

5) Implementing Measures on Import and Export Licenses for Enterprises with Foreign Investment, issued on Jan. 24, 1987, by MOFERT [hereinafter Licensing Rules].

6) The Rules of the Ministry of Foreign Economic Relation and Trade for the Implementation of, Confirmation and Examination of Export Enterprises and Technologically Advanced Enterprises with Foreign Investment, issued on Jan. 27, 1987 [hereinafter MOFERT Rules on JV Preferences].

reserves of other joint ventures in the same jurisdiction.¹⁶³ This adjustment is done by the local or central supervising authority. The Chinese authority may also adjust the unbalanced foreign exchange accounts from its own reserves if the joint venture in question sells primarily to the Chinese domestic market.¹⁶⁴ Though adjustment of foreign exchange accounts through regional surplus is a new resource for joint ventures, there are no detailed rules on applying for the readjustment.

A limitation on governmental adjustment is found in Article 7 of the Foreign Exchange Balance Provisions. If a joint venture fails to fulfill export and foreign exchange earnings goals set out in the joint venture contract, the relevant Chinese authority will not offer readjustment of foreign exchange accounting. Accordingly, foreign investors should be especially cautious in undertaking export commitments in the contract. To obtain maximum protection, foreign investors should stipulate in the joint venture contract the circumstances under which the Chinese government will be responsible for the foreign exchange readjustment.

Overall, it appears that the new readjustment measure will play an important role in giving foreign investors security against the strict Chinese accounting rules. A shortcoming in the provision is that it can be used only when many foreign investment enterprises in China are rich in foreign exchange and are willing to swap this surplus for Chinese currency. In addition, the the readjustment provision currently lacks detailed provisions for implementation.

2. Larger proportion for domestic sales

Preferential treatment with respect to the proportion of and the time period allowed for the sale of a joint venture's products on the domestic market may be permitted according to Article 4 of the new regulations, if the products at issue are sophisticated and manufactured with advanced or key technology provided by foreign partners, or are high-quality and competitive on the world market, and if China is in urgent need of the products. Such products are subject to quality appraisals by the relevant department in charge, and approval for preferential treatment must be secured from the Chinese government. The same article also requires that domestic sales be defined by the contract signed between joint ventures and Chinese companies.

¹⁶³ According to MOFERT officials' explanation, "foreign exchange voluntarily converted by exchange-rich joint ventures needing Renminbi for local costs will be held in reserve and used to meet the needs of deficit-ridden ventures that sell domestically." Gelatt, *The Foreign Exchange Quandary*, 13 CHINA BUS. REV. 29 (May-June 1986).

¹⁶⁴ JVR art. 75.

If all of these conditions are satisfied, the foreign exchange account of a joint venture will be readjusted by the Chinese central or local government. Like Article 3, Article 4 is likely to be confined by China's limited foreign exchange reserves. Thus, during the next few years, China may not be in a position to offer this treatment to a large number of joint ventures.

3. *Import Substitution*

Article 5 of the Foreign Exchange Balance Provisions provides that products manufactured by a Sino-foreign joint venture may be sold domestically as import substitutes for foreign currency if such products can replace the products that China needs to import in the long term or are urgently needed on the domestic market. This treatment must be spelled out in the joint venture contract or defined in the sale contract signed by the joint venture and the Chinese companies, and it is subject to Chinese government approval.

To a certain extent, Article 5 reiterates Article 64 of the Joint Venture Regulations, which states that "export products of joint ventures that are the goods (materials) which the Chinese trade corporations want to import may be sold by joint ventures to the Chinese trade corporations for foreign exchange." The major difference is that under Article 64 of the JVR, joint ventures can only sell their products as import substitutes to the "Chinese Trade Corporations." Article 5 of the new regulations allows joint ventures to sell their import substitutes to any "Chinese end-user units" and requires the Chinese government to actively support such arrangement.

Import substitution is a reasonable measure of resolving joint ventures' foreign exchange problems and is economically beneficial to China's economy. However, implementation of this measure may be difficult since Chinese trade corporations have already established their own channels and overseas clients for their imports and Chinese end-users may insist on buying foreign products with which they are familiar, instead of the joint venture products. Pursuant to this scenario, the joint venture products may be turned down by Chinese companies or end-users as unqualified import substitutes. Detailed rules to support this measure are currently being drafted by the Chinese government and will be made public in the near future.¹⁶⁵

¹⁶⁵ Gu Mu, State Councilor in charge of the State Council Leading Group on Foreign Investment, stated in 1986 that specific regulations on preferences for import substitution joint ventures and export-oriented joint ventures were being drafted. Because of the complexity of such regula-

4. *Exporting Chinese Products*

Article 6 of the Foreign Exchange Balance Regulations provides that Sino-foreign joint ventures that experience difficulty balancing their foreign exchange accounts may export Chinese products through their own channels to offset the shortages of their foreign exchange, if they receive approval of the relevant foreign economic and trade department. Special export permission is required from MOFERT if the products are to be exported under the unified state plan, export quotas and export license. This provision is a major step forward and a conceptual breakthrough from the original Chinese joint venture law and regulations. If this measure is implemented effectively, it will not only help joint ventures resolve their foreign exchange difficulties, but may also promote China's exports.

In accordance with the Provisions of the State Council for the Encouragement of Foreign Investment, the Provisions on the Purchase and Export of Domestic Products for Enterprises with Foreign Investment for Balancing Their Foreign Exchange Accounts were issued in January 1987.¹⁶⁶ These provisions emphasize that enterprises with foreign investment should balance their foreign exchange account by exporting their own products. If the enterprises run into "temporary difficulties" in foreign exchange, they may "within a certain period of time," apply to export any domestic products other than "those products subject to unified handling under the state regulations."¹⁶⁷ The following principles and procedures govern the export of domestic products.

a. Application

An enterprise with foreign investment that complies with the above conditions should first apply to the local provincial department of foreign trade and indicate: 1) the amount of foreign exchange required to balance accounts for that year; 2) the equivalent amount in yuan; 3) the name, specifications and quantity of the domestic product intended to be ex-

tions, they will likely be the last of the implementing rules for the 22 Provs. designed to encourage investment issued. Sullivan, *supra* note 161, at 9.

¹⁶⁶ Provisions on the Purchase and Export of Domestic Products for Enterprises with Foreign Investment for Balancing Their Foreign Exchange Accounts, *reprinted in* China Daily, Jan. 23, 1987, at 2 [hereinafter Domestic Product Export Provs.]. The JV Foreign Exchange Balance Provs. only apply to Sino-foreign equity joint ventures. JV Foreign Exchange Balance Provs., arts. I-II. The Domestic Product Export Provs.—formulated to implement art. 6 of the JV Foreign Exchange Balance Provs.—also extend to wholly foreign-owned enterprises the right to purchase and export Chinese domestic products to balance foreign exchange accounts. *See* the 22 Provs., art. 2.

¹⁶⁷ Domestic Product Export Provs., art. 2.

ported; 4) and the planned export channels for the goods.¹⁶⁸ If the domestic products are controlled by state export licenses or are subject to export quotas, the application must be approved by MOFERT. For other products, the provincial departments of foreign trade have the right to approve such applications and must record the matter with MOFERT. The approving department, no matter what the level, is required to give a clear answer within one month after receipt of the application.¹⁶⁹

b. Quantity

The export quantity of the domestic products will be limited to the amount of foreign exchange needed by the applying enterprise for production, operation, and repatriation of profits for the immediate year.¹⁷⁰

c. Purchase requirements

If a joint venture receives approval to export domestic products, it is required to purchase the products within the province in which it is located. If it is necessary to purchase the products from other provinces, prior permission from the relevant provincial department(s) of foreign trade is required.¹⁷¹

d. Export channels

The products in question may be exported either by the enterprise itself or by Chinese trade corporations through an agency arrangement. The products may not be resold within China.¹⁷²

e. Export licensing

The exporting enterprise should go through export licensing procedures in accordance with the Implementing Measures on Import and Export Licenses for Enterprises with Foreign Investment, if the approved exports require such licenses.¹⁷³

f. Local surplus

The new provisions also encourage the local governments, after fulfilling state export plans, to organize and export surplus products (prod-

¹⁶⁸ Domestic Product Export Provs., art. 3.

¹⁶⁹ Domestic Product Export Provs., art. 9.

¹⁷⁰ Domestic Product Export Provs., art. 4.

¹⁷¹ Domestic Product Export Provs., art. 5.

¹⁷² Domestic Product Export Provs., arts. 6-7.

¹⁷³ Domestic Product Export Provs., art. 9.

ucts not within the planned export items and volumes) to earn foreign exchange. After deducting the foreign exchange earnings to which the local supplier is entitled for the sale of the products, the remainder may, under the supervision of the local foreign exchange control authorities, be used by the local government for readjustment of currency accounts of foreign investment enterprises suffering from an imbalance of foreign exchange.¹⁷⁴

Two problems may emerge from this new set of measures. First, there is a question as to whether a joint venture can reasonably be expected to find products for export, particularly since the important and profitable "state unified handling products," such as oil, coal, soybeans, and key minerals are specifically excluded.¹⁷⁵ Second, even if appropriate products for export are located, it may be difficult to obtain government permission to export those products because most of the popular export goods are handled by Chinese trade corporations under government authorization. These trade corporations will logically seek to prevent the government from granting such enterprises the right to compete in the export of domestic products. To summarize, Article 6 can play a meaningful role in encouraging joint ventures only if the ventures can secure free access to Chinese export products and governmental support. It seems unlikely that this will occur.

5. Sales for Foreign Currency in China

Article 8 of the Foreign Exchange Balance Provisions allows joint ventures to sell products for foreign exchange. These sales are accomplished, upon the approval of the state foreign exchange control authorities, by quoting and settling between buyers' and sellers' foreign currency accounts. The purchasing Chinese companies must be located outside of the special economic zones (the "SEZs") and the economic and technological development zones (the "ETDZs") in the open coastal cities.

6. Pooling Foreign Exchange

A foreign investor who has two or more joint ventures operating in China may pool its foreign exchange accounts and offset the deficit in one joint venture's account by the surplus from another's.¹⁷⁶ This pooling

¹⁷⁴ Domestic Product Export Provs., art. 8.

¹⁷⁵ Article 6 of the JV Foreign Exchange Balance Provs. provides that joint ventures must obtain special permission if they export "state unified handling products." This implies that such enterprises can obtain such permission. Art. 2 of the new Domestic Product Export Provs., however, is a clear fallback from this previous implication.

¹⁷⁶ JV Foreign Exchange Balance Provs., art. 9.

must be agreed to by all the parties involved, and prior approval from the relevant state foreign exchange control department is necessary. As the number of joint ventures in China continues to grow, the pooling of foreign exchange may become an increasingly helpful way to solve the foreign exchange problem.

7. *Reinvestment of Yuan Earnings*

Another new measure under the Foreign Exchange Balance Regulations permits foreign partners experiencing deficits in their foreign exchange accounts to reinvest a share of their Chinese-currency profits in other domestic enterprises capable of earning foreign currency.¹⁷⁷ In so doing, the foreign exchange revenue of the new joint ventures may offset the foreign exchange deficit of the foreign investor's original joint venture. Moreover, they will enjoy an income tax refund of 40% if the new joint venture's term is over five years.

A shortcoming of this measure arises under the technology policy of the PRC. The PRC hopes that Sino-foreign joint ventures import high technology and advanced equipment, so that China can produce competitive products for the world marketplace. Accordingly, Chinese partners almost always require foreign partners to bring in hard currency and advanced equipment as capital contributions. Any state-owned enterprise that can expand its scale of production and exports may easily obtain a Chinese currency loan from a Chinese bank because of the government's policy of financing export production. Consequently, as long as money is available in the Chinese banks, Chinese enterprises will have no incentive to allow foreigners to invest Chinese currency and share foreign exchange earnings with them. Therefore, if foreign partners wish to reinvest in a more profitable Chinese enterprise in order to cover their original joint venture's foreign exchange deficits, they should be prepared to provide at least the minimum amount of foreign exchange or technology required by the new Chinese partners.

B. The Provisions for the Encouragement of Foreign Investment

The Provisions for the Encouragement of Foreign Investment (the "22 Provisions") were designed to create a more favorable foreign investment climate in China and to reverse the declining trend of foreign investment that began in 1986. This set of rules also seeks to encourage foreigners to invest their capital in Export Enterprises and Technologically Advanced Enterprises in China, by offering benefits to investors in

¹⁷⁷ JV Foreign Exchange Balance Provs., art. 10.

these areas. The 22 Provisions also aim to alleviate the burden of high operating costs suffered by foreign investors and to bestow more autonomy upon joint ventures in their business management. The new provisions—with the exception of those articles expressly applicable to Export Enterprises and Technologically Advanced Enterprises—are applicable to all foreign investment enterprises: Sino-foreign equity joint ventures, cooperative joint ventures and wholly foreign-owned enterprises.¹⁷⁸

1. Export Enterprises and Technologically Advanced Enterprises

A striking feature of the 22 Provisions is the strong preferential treatment which Export Enterprises and Technologically Advanced Enterprises with foreign investment receive over other foreign investment enterprises.¹⁷⁹ Designation of a foreign investment enterprise as an export enterprise is contingent on three conditions. First, the enterprise must produce exports;¹⁸⁰ second, the value of the exports produced must be greater than 50% of the value of total annual production;¹⁸¹ third, the enterprise must maintain a balance or surplus in its foreign exchange reserves.¹⁸²

A foreign investment enterprise may be categorized as a Technologically Advanced Enterprise if the project is included in a Chinese government project list and if the enterprise's technology and equipment are advanced, suitable, and in short domestic supply. An enterprise can also achieve this status if its products are newly developed or if it can upgrade and replace existing Chinese products so as to generate foreign exchange or to serve as an import substitute.¹⁸³

The Chinese government's purpose in offering preferential treatment to these two categories of enterprises is to encourage foreigners to invest their capital in high-technology production, in order to produce more export products or import substitutes. Consequently, nonproductive enterprises such as hotels, restaurants or other service industries, are not eligible for certification as export or high-technology enterprises.

¹⁷⁸ The 22 Provs., art. 19.

¹⁷⁹ After the enactment of the 22 Provs., various Chinese provincial governments announced a number of export-oriented or technologically advanced enterprises which would enjoy preferential treatment under the new laws. For example, Shanghai Municipality announced 69 such special joint ventures in October 1986. *People's Daily*, Oct. 27, 1986, at 3 (overseas Chinese ed.). In addition, 43 preferred enterprises were announced in Tienjing, *id.*; 24 in Beijing, *People's Daily*, Nov. 21, 1986, at 1 (overseas Chinese ed.); and 83 enterprises in Quandong, *People's Daily*, Dec. 13, 1986 (overseas Chinese ed.).

¹⁸⁰ MOFERT Rules on JV Preferences, art. 2.

¹⁸¹ *Id.*

¹⁸² MOFERT Rules on JV Preferences, art. 4.

¹⁸³ *Id.*

a. Procedures for approval

The provincial economic and trade departments are authorized to examine and approve export-oriented and Technologically Advanced Enterprises located in their respective territories.¹⁸⁴ MOFERT, however, is responsible for examination and approval of these enterprises when they are established between foreign investors and a government organ directly under the control of the State Council. Enterprises which wish to qualify as Export Enterprises or Technologically Advanced Enterprises must submit to the appropriate provincial department or MOFERT the relevant application form, copies of contractual and approval documents, and a project feasibility study, along with accompanying approval documents.¹⁸⁵ The relevant provincial department or MOFERT will examine and certify whether an enterprise is qualified to be an Export Enterprise within thirty days after receipt of these documents. If the application is for a Technologically Advanced Enterprise, the departments concerned will jointly examine and decide the application within the specified period of time.¹⁸⁶ If an enterprise is awarded special status, a certificate of qualification will be issued by either the provincial authority or MOFERT. A copy of the application and certificate should subsequently be filed with MOFERT and the State Economic Commission.¹⁸⁷

b. Verification

Export Enterprises and Technologically Advanced Enterprises must verify their status every year with the original certifying departments or with other departments set out in Articles 2, 3 and 4 of the 22 Provisions. The approved contract, the enterprise export plan and the annual export volume, technical index, product quality, and the percentage of local production content must also be reviewed.¹⁸⁸ If an enterprise is still qualified to be an Export or Technologically Advanced Enterprise after its annual review, the relevant departments will be notified, and the enterprise will enjoy the special preferential treatment in the following year.¹⁸⁹ Should the concern not requalify for special status during the year-end verification, it must repay the preferences it enjoyed during the previous year.¹⁹⁰ If it does not qualify for three consecutive years, the certificate

¹⁸⁴ MOFERT Rules on JV Preferences, art. 6.

¹⁸⁵ MOFERT Rules on JV Preferences, art. 7.

¹⁸⁶ *Id.*

¹⁸⁷ MOFERT Rules on JV Preferences, art. 8.

¹⁸⁸ MOFERT Rules on JV Preferences, art. 10.

¹⁸⁹ MOFERT Rules on JV Preferences, art. 11.

¹⁹⁰ *Id.*

of qualification for special status is revoked.¹⁹¹

c. Preferential treatments

After approval and verification by the Chinese government, Export Enterprises and Technologically Advanced Enterprises have the right to enjoy a variety of benefits.

1. *Lower labor costs:* Approved enterprises are exempted from paying all state employment subsidies,¹⁹² other than labor insurance, welfare costs, and housing subsidies for their staff and workers.¹⁹³ This exemption can result in a substantial savings.

2. *Lower site-use fees:* Enterprises located outside the busy urban sectors of large cities are charged 5 to 20 yuan per square meter annually for development and use of the site if such fees are consolidated.¹⁹⁴ If the development fee is charged on a one-time basis, or if the site is developed solely by the enterprise, an annual use fee of up to 3 yuan per square meter is all that is assessed. In addition, the new regulations give provincial or local governments discretion to grant further reductions or exemptions to the special enterprises, within a specified period of time.¹⁹⁵

3. *Priorities for services and bank loans:* Export and Technologically Advanced Enterprises will be given priorities in obtaining the supply of water, electricity, transportation, and communications services, and will pay the same level of fees charged to the local state-owned enterprises in similar industries.¹⁹⁶ Given China's less-developed infrastructure, sufficient supplies of these basic industrial necessities are key to a business's success. It does appear then, that the 22 Provisions offer some important conditions towards the encouragement of foreign investment.

The preferences bestowed under the 22 Provisions, however, raise other questions in foreign investors' minds. Article 5 of the 22 Provisions grants the Export and Technologically Advanced Enterprises national treatment with respect to the payment of fees for the supply of the crucial industrial goods and services. This article implies that those foreign investment enterprises not categorized as Export or Technologically Advanced Enterprises may have to pay higher fees for the same items. These less-privileged enterprises would certainly balk at such discrimina-

¹⁹¹ *Id.*

¹⁹² State subsidies include subsidies for heat, cooking coal, grain allowance, and other staples. See Cohen & Chang, *New Foreign Investment Provisions*, 14 CHINA BUS. REV. 12 (Jan.-Feb. 1987).

¹⁹³ The 22 Provs., art. 3.

¹⁹⁴ The 22 Provs., art. 4(1).

¹⁹⁵ *Id.*

¹⁹⁶ The 22 Provs., art. 5.

tion and might challenge this provision and request equal access and payment terms for such supplies.

According to Article 6 of the 22 Provisions, the privileged enterprises may also have priority in obtaining short-term loans for production and distribution purposes, as well as other necessary credit from the BOC. If such a loan is in Chinese yuan, the interest rate will be fixed by the BOC. If the loan is in foreign currency, the interest rate fixed by the BOC should be generally followed, although the borrower and the lender may choose to negotiate on interest rates in light of the international financial market.¹⁹⁷

4. *Additional Tax Reductions and Exemptions:* Foreign investors to an Export or Technologically Advanced Enterprise will be exempt from paying the 10% remittance income tax.¹⁹⁸ Furthermore, after the income tax exemption and reduction period under Chinese law expires, an Export Enterprise which exports 70% or more of its products in any one year will enjoy a 50% reduction in the income tax rate for that year. Such an enterprise will only pay 15% of the national income tax.¹⁹⁹ According to Article 8 of the 22 Provisions, Export Enterprises located in an SEZ or an ETDZ, and Export Enterprises that already pay 15% income tax, need only pay a 10% income tax. Technologically Advanced Enterprises will be allowed a 50% percent reduction in income tax for an additional three years after the period of income tax exemption and reduction lapses.²⁰⁰ A foreign investment enterprise may qualify both as an Export Enterprise and a Technologically Advanced Enterprise in the same period of time. In this case, the enterprise has the right to choose which preferential treatment it wishes to enjoy, but it may not have both.²⁰¹

2. *Encouragement to Reinvest*

If a foreign investor reinvests its profits to expand or establish another Export or Technologically Advanced Enterprise for a period of operation of not less than five years, the total enterprise income tax paid on the reinvested portion will be refunded upon the approval of the tax authorities.²⁰² If such profits are reinvested into enterprises other than Ex-

¹⁹⁷ People's Daily, Oct. 31, 1986, at 3 (overseas Chinese ed.).

¹⁹⁸ The 22 Provs., art. 7.

¹⁹⁹ The 22 Provs., art. 8.

²⁰⁰ The 22 Provs., art. 9.

²⁰¹ See generally MOFERT Rules on JV Preferences. Such enterprises could, for example, enjoy income tax exemptions in the first two profit-making years and a 50% income tax reduction in the following six years.

²⁰² The 22 Provs., art. 10.

port or Technologically Advanced Enterprises, the investors will only be given a 40% refund.²⁰³

3. *Exemption from Consolidated Industrial and Commercial Tax*

Article 11 of the 22 Provisions provides that export products produced by foreign investment enterprises—with the exception of crude or finished oil and other products subject to special state regulations—will be exempt from the CICT.²⁰⁴ Exports by foreign investment enterprises in the SEZs, the fourteen coastal cities, and other economic and technological development zones are already exempted from the CICT.²⁰⁵ Thus, this provision merely extends the tax preferences to the rest of China and repeals the requirement of prior approval of the Joint Venture Regulations for Sino-foreign joint ventures seeking the CICT exemption for exports.²⁰⁶

4. *Simplified Import and Export License Procedures*

Following the adoption of the 22 Provisions, the Implementing Measures on Import and Export Licenses for Enterprises with Foreign Investment (the "Licensing Rules") were issued by MOFERT on January 24, 1987. These rules simplified the import and export licensing procedures for such enterprises.

a. Import licenses

1. *Imports as capital contribution:* Pursuant to Article 2 of the Licensing Rules, foreign investment enterprises must apply for an import license if equipment and materials are imported as the foreign investor's capital contribution. This is accomplished by presenting the approved list of equipment and other materials to the Chinese government departments in charge. Imports not falling under this rule do not require a license; the Chinese customs service will simply examine and release them at the border according to an approved list of equipment and materials published by the government. Since the listed items are primarily consumer products,²⁰⁷ only a limited number of items, such as motor vehicles and computers, require import licenses.

2. *Imports for performance of export contracts:* Foreign investment enterprises which need to import machinery, equipment, production ve-

²⁰³ JVIT art. 6.

²⁰⁴ CICT art. 11.

²⁰⁵ See CICT arts. 5-6.

²⁰⁶ JVR art. 72.

²⁰⁷ See List of State-restricted Goods, reprinted in INVESTMENT GUIDE, *supra* note 4, at 546.

hicles,²⁰⁸ raw materials, fuel, spare parts, accessories, and components in order to fulfill export contracts need not obtain import licenses, even if the items appear on the state import licensing list.²⁰⁹ The Chinese customs service will examine and release these goods on presentation of the approved enterprise establishment documents and the relevant contract. Such imported goods must be for use by the importing enterprise itself, however, and may not be transferred or resold to any other enterprise in China. If the products manufactured with the imported materials or spare parts are to be sold domestically, the foreign investment enterprise must reapply for import licenses every six months.

3. *Imports for domestic sales:* Foreign investment enterprises which need to import materials and equipment for the production of approved products to be sold domestically are required to apply for import licenses for controlled items every six months, in accordance with their respective certified import plans.²¹⁰ If the goods do not require import licenses, Chinese customs will examine and release the goods upon presentation of the approved enterprise establishment documents and contracts.²¹¹

4. *Nonproductive imports:* Article 5 of the implementing rules allows "reasonable quantities" of non-productive articles to be imported by foreign investment enterprises for their own use. Such articles require import licenses upon application to the provincial foreign economic and trade commission.

b. Export licenses

Foreign investment enterprises must apply for export licenses every six months in order to export products falling under state export license control.²¹² If such export products are not controlled, the Chinese customs service will examine and release the goods upon presentation of the enterprise export contract.²¹³

If a foreign investment enterprise needs to export products other than its own in order to balance its foreign exchange accounts, it must secure the relevant export permission documents and apply for the appropriate export licenses pursuant to the export permission documents.²¹⁴ If no license is required, the Chinese customs service will

²⁰⁸ "Production Vehicles" refers to any vehicle, including those which serve as passenger and cargo transport. Licensing Rules, art. 3.

²⁰⁹ *Id.*

²¹⁰ Licensing Rules, arts. 3-4.

²¹¹ Licensing Rules, art. 4.

²¹² Licensing Rules, art. 6.

²¹³ Licensing Rules, art. 7.

²¹⁴ Licensing Rules, art. 8.

examine and release the goods upon presentation of the enterprise's export contract and other relevant documents.

The new provisions make several major improvements upon the old provisions.²¹⁵ First, the old regulations only applied to Sino-foreign equity joint ventures and Sino-foreign cooperative ventures; the new provisions apply to wholly foreign-owned enterprises as well. Second, for items such as foreign capital contribution, foreign investment enterprises need only obtain import licenses for those items which are controlled. Accordingly, fewer items than previously required by Article 63 of the Joint Venture Regulations need such licenses. Third, the new provisions eliminate the requirement for licensing of imported items used for the performance of export contracts. In the past, joint ventures had to apply for import licenses every six months if state regulations required import licenses for such items. That rule no longer applies.

5. Foreign Exchange Swap Among Joint Ventures

As previously observed, one of the major problems faced by Sino-foreign joint ventures is how to generate sufficient foreign exchange to import necessary materials and equipment for production and to repatriate profit from China. The Chinese government is seeking to resolve this problem through a variety of means discussed above. The 22 Provisions also allow foreign investment enterprises which run deficits in foreign currency, but have Chinese currency surplus, to swap with other enterprises for foreign exchange.²¹⁶ This foreign exchange transaction takes place under the supervision of the Chinese foreign exchange control authorities, although their approval is not required. Such foreign exchange swaps are likely to occur, because some foreign investment enterprises, such as hotels and restaurants, may need Chinese yuan to carry on business. Moreover, the enterprises which engage in swaps may set their own exchange rates.²¹⁷ The Chinese government allows such negotiation in private party swaps.²¹⁸

6. Renminbi Loans Secured by Foreign Exchange

To implement the 22 Provisions, the Interim Procedures Concerning Renminbi Loans to Foreign Investment Enterprises Secured by For-

²¹⁵ The rules which were replaced are JVR art. 62, and art. 9 of the Detailed Implementing Rules on the Licensing System for Imported Goods, May 15, 1984.

²¹⁶ The 22 Provs., art. 14.

²¹⁷ Horsley, *China's New Foreign Investment Provision*, 8 E. ASIAN EXEC. REP. 8 (Nov. 1986).

²¹⁸ In one transaction, for example, the Beijing Great Wall Hotel sold \$2.5 million to the Beijing Jeep Co., which was experiencing foreign exchange problems. *People's Daily*, Nov. 21, 1986, at 1 (overseas Chinese ed.).

ign Exchange²¹⁹ were issued by the People's Bank of China in December 1986 (the "Secured Loan Procedures"). The purpose of these provisions is to provide renminbi loans to foreign investment enterprises which have a surplus of foreign exchange (including foreign exchange borrowed from outside of China), but which need renminbi for revolving fund and fixed assets investments.²²⁰ In such cases, the foreign investment enterprise can deposit surplus foreign exchange in the BOC, or other financial institutions authorized by the BOC, and borrow the equivalent amount in renminbi as either a short-term (for three, six or twelve months) or a long-term (from one to five years) loan.²²¹ A depositing business maintains the ownership of the foreign exchange and can use the funds for imports, repatriation of profits, and currency swaps with other foreign investment enterprises, once the renminbi loan is repaid.

To obtain these collateralized loans, the foreign investment enterprise must supply to the State Administration of Foreign Exchange Control, or its branch office, a statement of the sources and amount of the funds involved. After receiving that department's approval, the enterprise may proceed to an authorized bank to apply for the loan.²²² If the secured loan application is approved by the bank, a loan contract will be concluded between the enterprise and the authorized bank.²²³ The Secured Loan Procedures also state that the borrowing enterprise cannot repay the loan before its maturity. The lending provisions effectively freeze the exchange rate for a secured loan. If the loan becomes due, the borrower must repay the original amount of the renminbi loan. The lending bank must return the amount of foreign exchange deposited without accounting for fluctuations in the foreign exchange rate²²⁴ or paying interest to either side.²²⁵ Should the enterprise not be able to repay the renminbi loan upon its maturity, the foreign exchange collateral becomes the property of the BOC.²²⁶

The maximum amount of a secured renminbi loan which can be granted by the authorized bank may not exceed the amount of the collateral based on the exchange rate (i.e., buying rate) published by the State

²¹⁹ Interim Procedures Concerning Renminbi to Foreign Investment Enterprises Loans Secured by Foreign Exchange, issued Dec. 12, 1986 (hereinafter Secured Loan Procs.), *reprinted in* China Daily, Dec. 13, 1987.

²²⁰ Secured Loan Procs., arts. 1-2.

²²¹ Secured Loan Procs., art. 3.

²²² Secured Loan Procs., art. 6.

²²³ Secured Loan Procs., art. 7.

²²⁴ Secured Loan Procs., art. 8.

²²⁵ Secured Loan Procs., art. 10.

²²⁶ Secured Loan Procs., art. 8.

Administration of Foreign Exchange Control on the date when the foreign exchange is pledged.²²⁷ At present, the BOC allows only the United States dollar, the Japanese yen, the Hong Kong dollar, the German mark and the English pound as foreign exchange collateral.²²⁸

7. Vesting Autonomous Operation

One important breakthrough provided by Article 15 of the new 22 Provisions is that enterprises with foreign investment are accorded the right to manage independently their businesses and employees. Article 15 also requires the Chinese government, at all levels, to guarantee and support such self-management in accordance with "internationally advanced scientific methods."

a. Self-planning productions and operations

Pursuant to Article 15 of the 22 Provisions, the owner of an enterprise has the right to determine the production and operation plans of the enterprise, within the scope of its business. This is a remarkable and laudable change from the previous requirement under Article 55 of the Joint Venture Regulations. Under the old provision, joint ventures were required to report their production and operation plans to the appropriate department and, although the Chinese government was prohibited from issuing mandatory plans to joint ventures, it did not preclude the government from issuing constructive plans. As a result, prior to the issuance of the new regulations, the state constructive plan could intervene in a joint venture's production and operation.

The new provision indicates that foreign investment enterprises will have the full right to decide what and how much they wish to produce within their business scope without interference from the Chinese government. Given China's centrally planned economy, with market forces only serving as a supplementary device to the whole economy, Article 15 represents a liberal policy change by the Chinese government with respect to absorption and use of foreign investment.

b. Self-management in pricing, buying, and selling

Article 15 also gives foreign investment enterprises the right to purchase production materials and manage the sale of their products. In contrast, Articles 57 through 66 of the Joint Venture Regulations place several restrictions and guidelines on the pricing, buying, and sale of joint

²²⁷ Secured Loan Procs., art. 9.

²²⁸ Secured Loan Procs., art. 4.

venture products. For example, joint ventures can obtain products labeled "materials under planned distribution" only from the designated department. Such products can be sold only to designated customers in China, according to the government's plans of supply and demand.²²⁹ Joint ventures are also required to report their export prices to the supervising department and price control authorities, although the prices may be set by the enterprise.²³⁰

The Joint Venture Regulations reflect the fact that the Chinese government, at the time of the Joint Venture Regulations' drafting, wished to keep joint venture production activity within the realm of the government's planned economic system and under strict control. Article 15 of the 22 Provisions reveals fundamental improvements over the previous regulations, especially with respect to the new management policies. Even so, this policy needs to be tested by practice, and further clarification of the differences between Article 15 and the previous provisions is needed.

c. Self-management in employment

Provisions regarding labor and employment are another important improvement under the new 22 Provisions. Article 15 provides foreign investment enterprises the right to determine their own form of wages, bonuses, and allowances. In addition, enterprises are now allowed to create and implement their own personnel policies, including sanctioning and/or dismissing of employees, and hiring of staff and workers of their choice within the region in which the joint venture is located. Article 15 also requires the unit to which such employees belong to support and permit personnel transfers. Some socialist control remains, however, as an enterprise that hires or fires staff and workers must file a report with the local labor and personnel department. The Labor and Personnel Ministry has issued detailed supplemental rules to Article 15 of the 22 Provisions.²³¹ Although many of the supplemental provisions are similar to those in Article 15, four new provisions were added. First, if engineering and managerial personnel are not available in the region where a foreign investment enterprise is located, the enterprise may hire such personnel from other regions after the local labor department has contacted and received permission from the labor authorities in other regions.

Second, Chinese managers have received greater independence from state control. The governmental departments are now required to sup-

²²⁹ JVR arts. 58, 64.

²³⁰ JVR art. 66.

²³¹ See Insurance & Welfare Provs., *supra* note 162.

port the work of Chinese executives appointed by the Chinese side in a joint venture. In addition, the senior authority of the Chinese partners cannot remove such people from their posts, unless such removal is necessary. The consent of the enterprise's board of directors must be obtained.

Third, wage levels of the staff and workers in foreign investment enterprises will be set by the business's board of directors at not less than 120% of the average wage level of the staff and workers hired by state-owned enterprises in similar industries in the same region. Fourth, foreign investment enterprises must pay Chinese staff and workers for retirement pensions, unemployment insurance, and housing subsidies, in accordance with the local regulations. The enterprise must also pay Chinese staff and workers for insurance and welfare fees during their employment term, consistent with the regulations governing state-owned enterprises in similar industries.

By allowing greater managerial freedom with respect to employment practices and by removing the obligations to pay for various government subsidies, the new provisions, to a large extent, release foreign investment enterprises from the restrictions of the former labor regulations.

8. Prohibiting Unreasonable Charges and Requiring Efficient Government Work

Responding to complaints of high production and operation costs faced by foreign investment enterprises, the new 22 Provisions require all levels of the Chinese government to curb excess charges imposed upon enterprises. Pursuant to Article 16 of the Provisions, enterprises may refuse to pay unreasonable charges or may appeal to the local government or the State Economic Commission for relief.

On a more administrative level, Article 17 requires that all levels of government improve coordination between foreign enterprises and themselves, increase bureaucratic efficiency, and promptly examine and approve matters referred to them by foreign investment enterprises. Bureaucracy and red tape have long been headaches for foreign investors dealing with the Chinese authorities, enterprises, and even with Chinese partners. Whether this particular provision can help to alleviate these impediments will depend on implementation by the Chinese authorities. The perception exists that without further social and economic reforms such problems may not be resolved satisfactorily.

VI. CONCLUSION

Eight years have passed since the doors opened to foreigners in China. During this period, the Chinese government has established a variety of domestic laws and regulations concerning foreign investment. They have also acceded to a number of international agreements promoting and protecting foreign investment, and avoiding double taxation. Chinese leaders often emphasize that the open door policy will remain unchanged. Considering that China has obtained direct foreign investment exceeding \$6.1 billion through 7,000 foreign investment enterprises within this short period of time, and that more foreigners are planning to invest in China, the open door policy appears quite successful.

This achievement should be qualified, however, by mentioning certain other factors. First, most of the foreign investment enterprises are either small in size or concentrated mainly in the service industry. Second, the total amount of direct foreign investment is far behind what the Chinese government had hoped for and needed. Third, many foreign investment enterprises are established between Chinese enterprises and Chinese government-owned enterprises in Hong Kong. The favorable figures are thus somewhat exaggerated. Finally, and most importantly for developing China, enterprises employing high-technology and advanced equipment are still scarce.

Foreign investment in China can increase if China's investment climate improves. For this to occur, the Chinese government must complete and perfect its foreign investment procedures and related laws and regulations. Foreign lawyers and investors frequently complain that the present law and regulations are still too general, ambiguous, and at times contradictory. This may lead to differing explanations and enforcement of the laws and regulations in China, and it forces parties to include detailed provisions in their contracts only after prolonged negotiations.

Despite the open doors, foreign investors still question the real autonomy of foreign investment enterprises in their production and business management. Although the laws and regulations provide a significant amount of administrative authority, the lack of administrative law and the existing procedures used by the government may exacerbate such concerns. To remedy these concerns, China should begin to develop its own administrative law and to enforce existing law with flexibility, with a view toward attracting more foreign investment.

On a more profound level, many western lawyers realize that it is basically unwise to focus upon Chinese law when advising clients interested in pursuing joint ventures in China. Chinese government policy is clearly more important because of its unpredictability and great ability to

affect businesses. In order for China to sustain a high level of long-term foreign investment, Chinese policy must be consistent, and foreign investors must be assured that Chinese law will protect their business interests.

Foreign investment enterprises utilize western economic philosophy to manage production and distribution in China. China, on the other hand, is still a centrally planned economy, with market forces existing only as a supplementary mechanism. Whether these entirely different systems can function smoothly together is not only a theoretical issue, but also a practical matter, concerning both the Chinese government and foreign investors. Foreign investment alone cannot be used as an expedient measure to develop China's economy. China must have a long-term strategy, an established legal framework, and consistent and stable policies. If China takes visible steps to perfect its legislation and further the development of China's political, social, and economic reforms, foreign companies would invest their money more boldly in China.

Foreign investors, on the other hand, must view their investment in China as a long term commitment. They must understand and recognize China's needs, Chinese tradition, Chinese culture, and the Chinese social system. Counsel to foreign investors should assist their clients in bridging the gap between the two different politico-economic philosophies and systems. They should devise acceptable and legitimate ways to overcome the obstacles before them in order to insure successful business. Successful investment in China presents a great challenge not only to Chinese society, but also to western lawyers and investors. The challenge must be met by all to assure that the bamboo shoots may one day grow to be a forest.